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Before the Committee on Appropriations

Treasury, Postal Service, and General Government Appropriations

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Fiscal Year 1981

96th CONGRESS, SECOND SESSION

H.R. 7583

PART 1 (Pages 1–867)

ADVISORY COMMITTEE ON INTERGOVERNMENTAL RELATIONS
GENERAL ACCOUNTING OFFICE
DEPARTMENT OF JUSTICE
DEPARTMENT OF THE TREASURY
NONDEPARTMENTAL WITNESSES
U.S. POSTAL SERVICE

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1981

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

UNITED STATES SENATE

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

H.R. 7583

AN ACT MAKING APPROPRIATIONS FOR THE TREASURY DEPARTMENT, THE UNITED STATES POSTAL SERVICE, THE EXECUTIVE OFFICE OF THE PRESIDENT, AND CERTAIN INDEPENDENT AGENCIES, FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 1981, AND FOR OTHER PURPOSES

PART 1 (Pages 1–857)

Advisory Committee on Intergovernmental Relations

General Accounting Office

Department of Justice

Department of the Treasury

Nondepartmental Witnesses

U.S. Postal Service

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CONTENTS

TUESDAY, APRIL 15, 1980

Page
Department of the Treasury 1
General Accounting Office 45
Department of the Treasury:
  Office of the Secretary 59

WEDNESDAY, APRIL 16, 1980

Department of the Treasury:
  U.S. Customs Service 117
  Bureau of Government Financial Operations 217
  Bureau of the Public Debt 257

THURSDAY, APRIL 17, 1980

Advisory Committee on Intergovernmental Relations 277
Nondepartmental witnesses 311
Department of the Treasury:
  Bureau of Alcohol, Tobacco and Firearms 319
  Federal Law Enforcement Training Center 435
  U.S. Postal Service 455

TUESDAY, APRIL 22, 1980

General Accounting Office 509
Department of Justice 571
Department of the Treasury:
  Internal Revenue Service 643
U.S. Postal Service 717
Department of the Treasury 791
  Bureau of the Mint 821

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1981

TUESDAY, APRIL 15, 1980

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, D.C.

The subcommittee met at 10:20 a.m., in room 1318, Everett McKinley Dirksen Senate Office Building, Hon. Lawton Chiles (chairman) presiding.

Present: Senators Chiles and Schmitt.

DEPARTMENT OF THE TREASURY

STATEMENT OF HON. G. WILLIAM MILLER, SECRETARY OF THE TREASURY

Senator CHILES. Good morning.

This morning the subcommittee will begin our hearings on fiscal year 1981 budget requests, the 1981 budget amendments and the fiscal year 1980 supplemental requests by receiving testimony from the Department of the Treasury.

The fiscal year 1980 supplemental requests for the Department of Treasury total $156,150,000, which includes $132 million plus for pay increases and $23 million plus for program increases. This total reflects a reduction of almost $8 million made to pending supplemental requests by the President in his budget reduction exercise of last month.

The Treasury's total request for fiscal year 1981 is $3,644,255,000, which reflects $53,295,000 of reductions proposed by the President in his budget amendments of last month. The subcommittee intends to examine these requests very carefully in the course of these hearings.

Today the subcommittee will hear testimony from the Secretary of the Department, the Office of the Secretary, and an overview of the fiscal year 1980 supplementals and the fiscal year 1981 budget amendments.

Following our discussion this morning with the Secretary, the committee will receive testimony from the General Accounting Office regarding the Department of Treasury's Inspector General function. The Treasury Department is one of the few major departments that does not have a statutory Inspector General. This fact, and recent allegations of fraud and misconduct by employees of the U.S. Customs Service and the Bureau of Alcohol, Tobacco and Firearms have led the committee to question the need for an expanded and strengthened Inspector General function at the department level.

Following the GAO testimony on this subject, the committee will continue its discussion of the Inspector General function with Mr. McDonald, Assistant Secretary for Administration, and Mr. Leon Wigrizer, the Inspector General at the Treasury Department.

We are honored to have the Secretary of Treasury, the Hon. G. William Miller, with us this morning.

Secretary Miller participated with other administration leaders and several of us in the House and Senate in recommending items to be included in the President's budget package of last month.

As you know, since that time both the House and Senate Budget Committees have proposed balanced budgets for the fiscal year 1981.

The administration is now proposing a balanced budget for fiscal year 1981. So we have created the momentum and the environment to have a balanced budget. It is now up to the Appropriations Committee and the authorizing committees to take the necessary action to bring the budget into balance.

As chairman of this committee, I certainly intend to do what I can to help make sure that this subcommittee makes its fair contribution toward the goal of the balanced budget, Secretary Miller, even if it comes out of Treasury's hide.

Secretary Miller, before we proceed with your statement, Senator Schmitt, the ranking minority member of the subcommittee, has an opening statement.

Senator SCHMITT. Mr. Chairman, I want to welcome the Secretary here. Our careers in the Congress, so to speak, have been overlapping. I was on the Banking Committee during his confirmation hearings for his previous position with the Federal Reserve Board. I am happy to have him here today.

I am anxious to work with the chairman in doing our part on this subcommittee in helping balance the budget. One area of particular concern that I hope the Secretary will address, and I have not had a chance to read his testimony and he may address it, is the extreme difficulty that Treasury and others have been having in making economic forecasts upon which the Congress and the American people can base some kind of future decisions.

As I recall, during Secretary Blumenthal's testimony last year, his estimate, Treasury's estimate for inflation during 1979 was 7.4 percent, when the actual CPI ended up being 13.3 percent. There is an estimate that fiscal year 1980 was 8 to 8.5 percent, when now we have been running for 3 months at something over 17 percent, over a factor of two higher than the estimate.

I hope in the course of the testimony, or the discussion with the Secretary, that we can find out, are we doing anything that we can rely upon for good estimates on inflation or other economic indicators? It makes it almost impossible to put together a budget when we can't estimate inflation within even a factor of two of what it is? So with that precursor to questions, I look forward to your testimony, Mr. Secretary, and appreciate your presence here today.

Senator CHILES. Mr. Secretary.

PREPARED STATEMENT

Secretary MILLER. Mr. Chairman, may I, with your permission, submit my prepared testimony for the record? Then I might just make a few opening remarks to play up the highlights of my testimony and call attention to some of the overriding aspects of our environment as we go into this budget process.

Senator CHILES. Your statement in full will be submitted in the record.

[The statement follows:]

STATEMENT OF G. WILLIAM MILLER

I am pleased to be here with you to discuss the Department of the Treasury operating budget request for fiscal year 1981.

The Treasury bureau heads will follow me in justifying their individual requests. With your permission, Mr. Chairman, I would like to insert in the record a summary of the highlights of our budget justifications before your Committee.

We are requesting $3.6 billion and 118,377 average positions for our regular operating appropriations for fiscal year 1981. This represents an increase of $35 million and 568 positions over fiscal year 1980, primarily in the Internal Revenue Service. These amounts reflect the President's budget revisions.

Before discussing the Treasury Department's budget requests, I would like to comment briefly on our overall economic policy. As you know, on March 14, President Carter announced strong new measures to arrest inflation. The steps he proposed are bound to be very painful and difficult. But I believe the American people, the Congress and the Administration are now united in their determination to bring inflation under control and to regain control over our economic destiny. This new consensus is the strongest tool of all in the fight against inflation.

The new measures we must take against inflation were developed through one of the most extensive consultations with Congressional leaders in our history. We are greatly heartened by the spirit of cooperation and determination reflected in these discussions.

The new measures mark a substantial intensification of our on-going anti-inflation efforts on every front: restraint in Federal spending to close the budget deficit, restraint on credit expansion, efforts to reduce oil imports, and structural reforms to enhance economic efficiency. The fight against inflation is a dynamic process. It cannot be won by a single "package" of measures. What is required is consistency and persistence, coupled with a willingness to adapt particular policies to changing economic circumstances.

Economic circumstances have changed significantly since the time the FY 1981 budget was put together last fall. Through the end of last year, virtually all of the acceleration in inflation was accounted for by energy, and by the higher home financing costs associated with more stringent monetary policy. But in January and February, this inflationary acceleration began to spread into a broad range of goods and services, indicating a worsening of long-term inflationary expectations.

At the same time, increased international tensions gave rise to concerns that expanded defense spending would increase the budget. Fears developed that the 1981 deficit would expand beyond the $16 billion represented by the President's proposals.

These forces also combined to generate serious disturbances in financial markets. Interest rates rose very rapidly on virtually all financial instruments and some financial markets virtually ceased to operate.

It was to respond forcefully to these changes in economic circumstances that the President announced new actions for combatting inflation, coupled with efforts to augment the programs already in place.

First: The balanced budget for FY 1981 that the Administration is submitting to the Congress will be the first balanced budget since 1969. We must recognize that prudent fiscal policy demands that the budget oscillate around a true balance over the business cycle. During the 1970's, we have had continuous deficits, in both good times and bad.

The new budget represents a powerful economic force. The swing toward fiscal restraint between FY 1980 and FY 1981 will be approximately $50 billion, the largest ever in nominal terms and one of the largest ever as a percentage of GNP. And this increased fiscal stringency begins immediately: many of the budget cuts will affect FY 80 as well as 1981, and the gasoline conservation fee already imposed by the President will begin generating revenues this spring.

Because of this shift in fiscal policy, Treasury demands on private capital markets will be reduced substantially. Our borrowing needs will be reduced for the rest of this fiscal year and, in the next fiscal year, there will also be a substantial reduction in net new borrowing.

Balancing the Federal budget is the single most important step we can take to reduce inflationary expectations and return order to capital markets.

Second: By invoking the Credit Control Act of 1969, the President has given the Federal Reserve new tools to slow the growth of consumer and business borrowing.

Much of the strong growth in consumer spending over the last year was fueled by increased consumer debt, and an accompanying decline in the personal savings rate to the lowest level in 30 years. From January 1979 to January 1980, balances due by consumers on bankcards and other revolving credit increased by 17 percent, and consumer loans at finance companies increased by 25 percent. It is essential that consumer borrowing not add further to inflationary pressures, either by stimulating consumption at the expense of savings, or by encouraging consumers to buy now in anticipation of higher prices later.

We have also seen very strong growth in business credit over the last few months. From late December through mid-March, business borrowing from all short-term sources grew at one of the fastest rates ever recorded for a similar period, a development clearly inconsistent with reducing inflation.

Relying solely on the traditional tools of monetary policy to diminish credit growth would have placed unnecessary strains on the financial system. The new tools under the Credit Control Act will mitigate that stress.

However, there actions imply no diminution in the Fed's commitment to deploy the conventional tools of monetary policy as an anti-inflationary weapon. The President invoked the Act in ways carefully designed to complement and make more effective the traditional methods of monetary control.

Third: The 10 cent per gallon gasoline conservation fee provides further impetus toward the vital objective of reducing our use of imported oil. Twice in the last 10 years, in 1974 and 1979, we experienced dramatic increases in the price of imported oil; both times inflation worsened seriously worldwide. In 1979 alone, the price of imported petroleum increased by about 100%. To regain control of our own economic destiny, we must reduce our dependence on imported oil.

We estimate the gasoline conservation fee will reduce oil imports by about 100,000 b/d in the short-run, and as much as 250,000 b/d over the longer-run. The fee is a transitional measure; the Administration will submit to the Congress a tax equivalent to an ad valorem tax on motor fuels. The new equivalent ad valorem tax will replace both the present 4 cents a gallon tax and the conservation fee once it becomes effective.

The steps the President took on March 14, in concert with the programs already in place, comprise a comprehensive attack on the major factors contributing to inflation. The program addresses the root causes of inflation, not merely the symptoms. We have endured a decade of persistent budget deficits, very high inflation, and soaring oil import bills.

Reversing these trends will take firm and patient leadership. I believe, however, that we will succeed. What we are witnessing in Washington and throughout the nation is, in my judgment, the formation of a new and deep commitment to a process of economic renewal.

Let me return now to the Treasury Department's fiscal year 1981 budget.

Fiscal Year 1981 Treasury Overview

As I mentioned before, the estimates contained in the President's budget for fiscal year 1981 indicate that the Treasury will require a total of $3.6 billion for operating accounts.

I would like to bring to the Committee's attention some of the highlights of the type and level of workload facing the Department in fiscal year 1981. For example:

-- The Department will process over 139 million tax returns in fiscal year 1981, an increase of over 2 million from the previous year.

-- We expect an increase of over 9 percent in delinquent tax accounts processed and secured.

-- We estimate that 40.3 million taxpayers will come to us for assistance.

-- We anticipate that 284 million persons will be arriving at U.S. borders -- 3 percent more than in

1980 -- and that we will be processing almost 5 million formal entries -- almost 7 percent more than 1980.

- -- We expect to manufacture approximately 15 billion coins in 1981.
- -- Over 153 million savings-type securities will be issued and almost 163 million retired.
- -- The Department will also issue 729 million checks, an increase of over 2 percent.

The $3.6 billion request for 1981 represents a net increase of $35 million and 568 average positions over 1980 levels. Of the total, $34 million and 409 average positions are needed to handle additional workload generated outside the Department and is totally uncontrollable by us. The Internal Revenue Service will need $22 million of this amount for processing and examining additional tax returns, collecting delinquent taxes and for legal services. $10 million will be needed by the Bureau of the Public Debt for issuing and redeeming securities, while the remaining $2 million is for other miscellaneous increases.

The major program expansion -- that is, an increase in the quality of our programs -- contained in our estimates involves $36 million and 1,166 average positions. This program increase is made up of several major items and many small but necessary items scattered throughout the Department. The increases are shown below:

-- $20.9 million and 989 average positions to provide resources in the Internal Revenue Service for matching of information returns and follow-up collections -- with an estimated revenue return of $375 million.

-- $5.1 million to provide for site preparation at several IRS Service Centers in support of the ADP Equipment Replacement Program.

-- $3.0 million and 135 average positions to provide additional resources in the IRS to collect unpaid accounts -- producing a revenue return of approximately $55 million.

-- $6.9 million and 42 average position for other program increases spread across the other Treasury Bureaus.

These increases are offset by a net reduction of $34.5 million and 1,007 average positions. This represents the cost of maintaining current operating levels on Treasury programs offset by one-time costs savings, management improvements, and productivity savings.

The operating accounts in the budget estimate reflect our continuing effort to strike a reasonable balance between the Department's program needs and the desire to stabilize the growth in Government spending. The increases in this budget do help offset the impact of inflation on the Department. It is my view that the budget estimate before you will assure that the revenue is protected, that income tax returns are processed, that customs declarations and duties are effeciently collected and deposited, and that alcohol and tobacco excise taxes are promptly collected. It provides adequate funding to secure necessary financing to pay the Government's bills and maintain the Government books in a businesslike manner.

In addition, the budget estimate provides for an even-handed law enforcement effort. While the significant responsibilities for law enforcement rest with the Department of Justice, the Treasury Department is responsible for that segment of law enforcement related to the protection of currency, the tax system, and the customs and excise taxes, as well as regulation and control of firearms, explosives, and smuggling.

I would like to insert Table 2 into the record to show the relationship between our average position and dollar requirements, as well as Table 3, which illustrates the detailed derivation of Treasury's "proposed authorized level for 1980."

Mr. Chairman, this concludes my prepared statement. I shall, of course, welcome the opportunity to answer any questions you may have. Thank you.

Table 1

THE DEPARTMENT OF THE TREASURY

Annual Approporiations for the FY 1980 and Estimates Requirements for FY 1981

(In Millions of Dollars)

Regular Operating Appropriations:	1980 Proposed Authorized Level	Revised 1981 Budget Estimates	Increase (+) Decrease (-) Compared to 1980
Office of the Secretary	$ 31.8	$ 34.0	$ +2.2
International Affairs	22.8	23.7	+.9
Federal Law Enforcement Training Center	13.4	13.4	---
Bureau of Gov't Financial Oper:			
Salaries and Expenses	190.0	188.0	-2.0
Payments to Guam, V.I. and American Somoa	2.0	---	-2.0
Government Losses in Shipment	.2	---	-.2
Bureau of Alcohol, Tobacco and Firearms	143.7	144.8	+1.1
U.S. Customs Service	464.3	465.7	+1.4
Bureau of the Mint:			
Salaries and Expenses	59.4	61.0	+1.6
Bureau of the Public Debt	209.6	196.6	-13.0
Internal Revenue Service:			
Salaries and Expenses	150.0	157.8	+7.8
Taxpayer Ser. & Returns Proc.	802.7	811.7	+9.0
Examinations and Appeals	837.3	852.9	+15.6
Investigations and Collections	501.4	536.7	+35.3
Total, Internal Revenue Ser.	2,291.4	2,359.1	+67.7
Payment Where Energy Credit Exceeds Tax Liability	1.9	---	-1.9
U.S. Secret Service	177.7	157.0	-20.7
TOTAL, Regular Operating Appro.	$3,608.2	$3,643.3	$+35.1

Table 2

THE DEPARTMENT OF THE TREASURY

Comparative Statement of Average Positions
Fiscal Year 1980 and 1981

(Direct Appropriations Only)

	1980 Authorized Level	Revised 1981 Budget Estimate	Increase (+) Decrease (-) Compared to 1980
Regular Operating Appropriations:			
Office of the Secretary	787	798	+11
International Affairs	487	458	-29
Federal Enforcement Training Center	253	256	+3
Bureau of Gov't Financial Oper.	2,750	2,696	-54
Bureau of Alcohol, Tobacco and Firearms	3,778	3,737	-41
U.S. Customs Service	13,643	13,529	-114
Bureau of the Mint	1,722	1,710	-12
Bureau of the Public Debt	2,679	2,640	-39
Internal Revenue Service:			
Salaries and Expenses	4,558	4,666	+108
Taxpayer Ser. & Returns Proc.	34,995	34,141	-854
Examinations and Appeals	30,367	30,292	-75
Investigations and Collections	18,264	19,928	+1,664
TOTAL, IRS	88,184	89,027	+843
U.S. Secret Service	3,526	3,526	---
TOTAL, Regular Operating Appro.	117,809	118,377	+568

Table 3

THE DEPARTMENT OF THE TREASURY
Derivation of "Proposed Authorized Level for 1980"
(In Thousands of Dollars)

1980 Appropriation...$3,435,622

Proposed Supplementals:

1. Pay Increase:

   a. Classified..........................$132,284
   b. Wage Board..........................   229   +132,513

2. Program:

   a. Government Financial Operations (Payments to Virgin Islands) - This proposed supplemental appropriation would provide funds to reimburse the Government of Virgin Islands for losses incurred under the Tax Reduction and Simplication Act of 1977......................$2,000

   b. Internal Revenue Service (Payment Where Energy Credit Exceeds Tax Liability) - Provides for additional payments to businesses when the solar wind credit due them exceeds the amount of tax liability owed.......................$1,000

c. Public Debt - Provides for increase workload occurring in savings bond redemptions, Treasury bill book-entry accounts, and other Bureau operations............................$23,558		
d. Secret Service - Provides for the increase cost of protective travel, Presidential candidate and nominee protection (10,800) and reimbursements to State and Local governments for protection of foreign diplomatic missions under extraordinary circumstances (2,750)...$13,550		+40,108
Proposed Appropriation Transfer:		
1. Office of the Secretary (transfer of Anti-Dumping and Countervailing Duty Program to Commerce)	-329	
2. International Affairs (transfer to Special Trade Representative)	-88	
3. U.S. Customs Service (transfer of Anti-Dumping and Countervailing Duty Program to Commerce)	-5,271	
4. U.S. Secret Service (transfer from Mint construction account to fund pay increase requirements)	+5,730	+42
Proposed Authorized Level for 1980............................		$3,608,285

HIGHLIGHTS OF THE PRESIDENT'S FY 1981 BUDGET

The President's Budget for the Department of the Treasury Requests $79,001,042,000 for FY 1981 -- a decrease of $16,333,208,000 compared to 1980. This represents an increase of $6,300,000,000 for interest on the public debt, an increase of $75,118,000 for operating accounts ($35,070,000 under Treasury-Post Office Subcommittee, $40,246,000 under Hud-Independent Agencies Subcommittee and a decrease of $198,000 under the State, Judiciary and Commerce Subcommittee), and a decrease of $22,708,326,000 in all other accounts, such as trust funds and revolving accounts, receipts, energy security corporation, and indefinite accounts. Funds for the Department's operating programs total $3,741,365,000 an increase of $75,118,000 over 1980. These operating programs are the ones that receive the most scrutiny by our Congressional Appropriations Committees.

Relative to the Department's employment, the budget provides for a 1981 level of 118,555 average positions (118,377 under Treasury-Post Office Subcommittee, and 158 under HUD-Independent Agencies Subcommittee and 20 under the State, Judiciary and Commerce Subcommittee) for the operating accounts, an increase of 576 (568 under Treasury-Post Office Subcommittee and 8 under the State, Judiciary and Commerce Subcommittee) compared to 1980.

Budget Authority Increases for Treasury Subcommittee Operating Accounts -- Net $35,070,000

+ 33,799,000 -- to meet workload increases, for the following items: $8.2 million for processing tax returns, $4.1 million for examination of tax returns, $7.0 million for collection of delinquent taxes, $3.0 million for legal services, $1.2 million for check issuance, $9.7 million for issuing and redeeming securities, $0.3 million for Office of the Secretary workload, and $0.3 million for other increases.

+ 20,869,000 -- to provide additional resources in the Internal Revenue Service for matching of information returns and follow-up collections.

+ 5,081,000 -- to provide for site preparation of several IRS Service Centers in support of the ADP equipment replacement program.

+ 2,980,000 -- to provide additional resources in the IRS to collect unpaid accounts.

+ 600,000 -- for repairs and improvements to the Treasury Annex elevators.

+ 2,937,000 -- to provide for acquisition of equipment in several Treasury bureaus.

+ 350,000 -- to provide additional resources in the Secret Service for technical security.

+ 700,000 -- for the Salary Equalization Program, Asian Development Bank.

+ 2,292,000 -- for other program increases.

+ 90,179,000 -- to maintain current levels of operation -- within-grade promotions, grade to grade promotion, space rental, FTS costs, printing costs, health benefits, etc.

-124,717,000 -- for non-recurring equipment, one-time costs, and savings and certain program reductions.

Employment - Increase of 568 Average Positions

+ 409 -- average positions of new employees to meet workload increases for the following items: 397 for collection of delinquent taxes, 10 for manufacturing of coins in Mint, 2 for the Office of the Secretary and Government Financial Operations.

+ 989 -- average positions to provide additional resources in IRS for matching of information returns and follow-up collections.

+ 135 -- average positions to provide additional resources in IRS to collect delinquent unpaid accounts.

+ 10 -- average positions for the check payment and reconciliation program in GFO.

+ 32 -- average positions for other program increases.

+ 34 -- average positions to provide full-year cost in 1981 for programs authorized for part of 1980.

- 1,041 -- average positions for non-recurring savings, program reductions, and productivity savings.

Assumptions

The estimates are based on the assumptions that:

-- All possible efforts will be made to hold Government expenditures to a minimum particularly in this budget year when most workload increases have been offset by productivity savings and program reductions.

-- Pay increases for classified employees under Executive Order 12165 will be provided in 1980 supplemental appropriations.

-- Increased productivity and management savings will be applied to the maximum extent.

-- Demands for Treasury services will continue to increase and must be met:

- Government checks issued and paid.

- Bond and security records maintained.
- Coins, currency and stamps produced for nation's commerce.
- Internal Revenue master file maintained in a current manner and tax returns processed.
- Check claims cases settled promptly.
- Cargo and persons entering our borders should be processed equitably and efficiently.
- Smuggling of all contraband should be identified and halted where possible.

Summary Analysis of FY 1981 Estimates for Operating Bureaus and Offices

Office of the Secretary - $33,995,000

-- Net increase is $2,241,000 and 11 average positions of employment.

-- $344,000 and 8 average positions are needed for increased workload.

-- $600,000 is requested for repairs and improvements to the Treasury Annex elevators.

-- $325,000 and 10 average positions are included for the new insurance office.

-- $1,477,000 and 2 average position are needed to maintain current levels of operations - within-grade promotions, annualization of pay increases, space rental costs, etc.

-- A reduction of $505,000 and 9 average positions are principally for non-recurring and one-time costs and productivity savings.

International Affairs - $23,671,000

-- Net increase is $834,000 and a decrease of 29 average positions of employment.

-- $700,000 is required for the Salary Equalization Program, Asian Development Bank.

-- $1,558,000 is provided to maintain current levels of operation -- within-grade promotions, price increases, annualization of pay increases, etc.

-- A reduction of $1,424,000 and 29 average positions is for productivity savings and non-recurring one-time costs.

Federal Law Enforcement Training Center - $13,400,000 for Salaries and Expenses

-- Net decrease for Salaries and Expenses of $2,000 and an increase of 3 average positions of employment.

-- An increase of $753,000 and 3 average positions are for the costs related to maintaining current levels of operations -- within-grade promotions, annualization of pay increases, price increases, etc.

-- A reduction of $755,000 is for productivity savings, program reductions, and non-recurring one-time costs.

Bureau of Government Financial Operations

Salaries and Expenses - $188,012,000

-- Net decreases are $2,027,000 and 54 average positions of employment.

-- $1,193,000 and a decrease of 6 average positions are for workload in the check issuance area.

-- $490,000 is to provide for ADP and capital equipment acquisitions.

-- $486,000 and 10 average positions are for the check payment and reconciliation program.

-- $229,000 and 5 average positions are for other program increases.

-- $1,539,000 is required to maintain current staff levels -- within-grades, space rental, annualization of postage increases and full-year costs of programs authorized for part of 1980.

-- Reductions of $5,964,000 and 63 average positions for management savings, non-recurring one-time costs and program reductions.

Payments to Guam, Virgin Islands and American Samoa - $-2,000,000

-- A net reduction of $2,000,000 for one-time payments occuring in 1980.

Government Losses in Shipment - $-200,000.

-- A net reduction of $200,000 for one-time payment occuring in 1980.

Bureau of Alcohol, Tobacco and Firearms - $144,844,000

-- A net increase of $1,142,000 and a reduction of 41 average positions of employment.

-- $997,000 is required for additional equipment.

-- $3,666,000 is for costs to maintain current levels of operations which include such items as within-grade promotions, grade to grade promotions, and increased printing, postage, and space costs.

-- A reduction of $3,521,000 and 41 average positions for program reductions and non-recurring costs and savings.

U.S. Customs Service - $465,700,000

-- Net increase of $1,361,000 and a reduction of 114 average positions of employment.

-- $1,450,000 is for additional vehicles and enforcement equipment.

-- $386,000 and 8 average positions are for the regulatory audit program.

-- $525,000 and 9 average positions are for safety and health programs.

-- An increase of $11,467,000 and 29 average positions are to maintain current levels of operation -- within-grade promotions, grade to grade promotions, price increases, annualization of pay increases, space increases, etc.

-- A reduction of $12,467,000 and 160 average positions are for non-recurring costs and savings, productivity savings, and program reductions.

Bureau of the Mint

Salaries and Expenses - $60,956,000

-- Net increase for Salaries and Expenses, $1,599,000 and a decrease of 12 average positions.

-- $205,000 and 10 average positions are for increased workload.

-- $4,323,000 is required to maintain current levels of operation -- within-grade promotions, annualization of pay increases, FTS costs, etc.

-- A reduction of $2,929,000 and 22 average positions is for non-recurring costs and savings and program reductions.

Bureau of the Public Debt - $196,625,000

-- A reduction of $13,015,000 and a reduction of 39 average positions of employment.

-- $9,671,000 is for compensation of issuing and paying agents for redemption and sale of savings bonds and reimbursement to Federal Reserve Banks for services.

-- $341,000 is for other program increases.

-- $2,418,000 to maintain current levels of operations, including such major items as within-grade promotions, annualization of pay increases, space rental costs, annualization of postage, etc.

-- A reduction of $25,445,000 and 39 average positions for non-recurring costs, and management savings.

Internal Revenue Service - $2,359,111,000

Salaries and Expenses - $157,762,000

-- A net increase of $7,782,000 and 108 average positions of employment.

-- $3,152,000 and 63 average positions are for increased workload.

-- $6,678,000 and 60 average positions are to maintain current levels of operations -- within-grade promotions, annualization of pay increases, space rental costs, etc.

-- A reduction of $2,048,000 and 15 average positions covering non-recurring costs and savings and program reductions.

Taxpayer Service and Returns Processing - $811,744,000

-- Net increase of $8,996,000 and a decrease of 854 average positions of employment.

-- $8,202,000 and 4 average positions for processing additional tax returns.

-- $5,750,000 and 302 average positions are for matching additional information returns and related follow-up collections.

-- $5,081,000 is for site preparation at several service centers in support of the ADP Equipment Replacement Program.

-- An increase of $13,856,000 and a reduction of 812 average positions is to maintain current levels of operations including such items as within-grade promotions, grade-to-grade promotions, annualization of pay raises, etc.

-- A reduction of $23,893,000 and 348 average positions is for non-recurring costs and savings and program reductions.

Examinations and Appeals - $852,925,000

-- A net increase of $15,609,000 and a decrease of 75 average positions of employment.

-- An increase of $4,069,000 for examination of additional tax returns.

-- An increae of $4,527,000 and 233 average positions for examinations of tax returns derived from the information returns program.

-- An increase of $19,103,000 and a reduction of 63 average positions are to maintain current levels of operations including such items as within-grade promotions, grade-to-grade promotions, annualization of pay increases, etc.

-- A reduction of $12,090,000 and 245 average positions is for non-recurring costs and savings and productivity savings.

Investigations and Collections - $536,680,000

-- A net increase of $35,259,000 and 1,664 average positions of employment.

-- $6,963,000 and 330 average positions are for collection of delinquent taxes related to additional workload.

-- $10,592,000 and 454 average positions are for follow-up investigations derived from the information returns program.

-- $2,980,000 and 135 average positions are for an increased effort to collect unpaid accounts.

-- $21,002,000 and 815 average positions to maintain current levels of operation -- within-grade promotions, grade-to-grade promotions, space rental costs, annualization of pay increases and programs authorized for part of FY 1980 etc.

-- A reduction of $6,278,000 and 70 average positions covering non-recurring costs and savings and program reductions.

Payment where Energy Credit Exceeds Tax Liability - $-1,900,000

-- Net decrease of $1,900,000 for one-time non-recurring costs in 1980 (this account is proposed as an indefinite in 1981).

U.S. Secret Service - $157,041,000

-- Net decrease is $20,609,000 with no change proposed in average positions.

-- $350,000 is for technical security equipment.

-- $2,339,000 is for those costs required to maintain current levels of operation -- within-grade promotions, grade-to-grade promotions, annualization of pay, space rental, etc.

-- A reduction of $23,298,000 is for non-recurring equipment costs and program reductions primarily related to the candidate and nominee protection program in the 1980 budget.

SUMMARY STATEMENT

Secretary MILLER. I appreciate the opportunity to discuss this budget proposal for fiscal year 1981.

I will give more or less an overview. I will be happy to answer questions, but there will be Treasury heads of offices and bureaus who will be following me to deal with the individual requests in more detail.

As we all know, we live in a time in which we have considerable difficulty in both forecasting economic trends and output and in dealing with the budgetary process in the context of that environment. Senator Schmitt has correctly pointed out the difficulties we have had.

We might come back to that in a moment. On March 14, President Carter did take some steps to intensify his effort to fight inflation. He did so after perhaps the most extensive consultations with the congressional leadership in our history. The new measures the President has undertaken in cooperation with the Congress include additional restraints on Federal spending to close the budget deficit, additional restraints on credit availability in targeted areas, new initiatives to reduce the demand for oil products and oil imports, and efforts to deal with some of the structural problems within our economy to enhance our economic efficiency.

The long war against inflation will not be won easily or quickly. There is no one set of tactical initiatives that will solve our inflation problem. But what is important that we have an overall comprehensive strategy and that we be willing to campaign on that strategy with such tactical adjustments from time to time as necessary. We will have to continue to monitor economic developments and be willing to move in response to the inevitability of change, much of which is beyond our control, as our whole economy is impacted by world events.

It is in the environment of these new austerity measures, these intensified anti-inflation measures that we are now presenting the Treasury's fiscal year 1981 budget. We are requesting a total of $3.6 billion.

Let me tick off some of the highlights of the type of level of the workload that is facing the Treasury Department in fiscal year 1981; as an example of some of the bases for change in our budget from fiscal year 1980.

Treasury will be processing through the IRS over 139 million tax returns in fiscal year 1981, an increase of over 2 million from the current fiscal year. We expect an increase of over 9 percent in delinquent tax accounts that need to be processed and collected.

We estimate that 40.3 million taxpayers will come to us for assistance in dealing with their tax issues. We anticipate that 284 million persons will be arriving at U.S. borders, 3 percent more than in 1980, and we will be processing about 5 million formal entries, about 7 percent more than this year.

We expect to manufacture approximately $15 billion in coins in fiscal year 1981. Over 153 million savings type securities will be issued and almost 163 million will be retired.

The Department will also issue 729 million checks, an increase of some 2 percent. So in the context of that kind of workload, the $3.6

billion request for 1981 represents a net increase of $35 million and 568 average positions over the 1980 levels.

The major program expansion, that is, an increase in the quality of our programs contained in our estimates, involves $36 million and 1,166 average positions. The program expansion is greater than the overall budget. There are offsetting reductions, but this program increase is made up of several major items and a number of smaller items that are scattered through the Department.

Major increases involve $21 million and 989 positions to provide resources of the Internal Revenue Service for matching information of returns and follow-up collections with an estimated revenue return of $375 million; that is, we spend $21 million in new resources and expect to collect $375 million.

There is also $5 million to provide for site preparation at several IRS service centers in support of automatic data processing equipment replacement. This is to modernize and upgrade our capacity. There is $3 million and 135 average positions to provide additional resources in the Internal Revenue Service to collect unpaid accounts, and we expect to derive $55 million from this activity.

Again, $3 million spent to raise $55 million. And we expect about $7 million and 42 average positions for other programs that are spread across the Treasury Department.

The operating accounts and the budget estimate reflect our continuing effort to strike a reasonable balance between the Department's program needs and workloads and the desire to stabilize the growth of Government spending in keeping with the President's initiatives and congressional initiatives.

The increases in this budget do help to offset the impact of inflation on the Department. It is my view that the budget estimate before you today will assure that the revenue is protected, that income tax returns are processed, and Customs declarations and duty are efficiently collected and deposited and that alcohol and tobacco excise taxes are properly collected. It provides adequate funding to secure necessary financing to pay Government bills and to maintain the Government books in a businesslike manner. In addition, the budget estimate provides for an even-handed law and enforcement effort.

While the significant responsibilities of law enforcement rest with the Department of Justice, the Treasury Department is responsible for that segment of law enforcement related to protection of currency, the tax system, and Customs and excise taxes, as well as regulation and control of firearms, explosives, and smuggling.

Mr. Chairman, Senator Schmitt, this is an overview, briefly, of the testimony that I have submitted. I would be very pleased to turn to your particular questions.

INTEREST AND DIVIDENDS WITHHOLDING

Senator CHILES. Thank you very much, Mr. Secretary. One of the revisions to the President's budget that is being proposed is legislative proposals to withhold interest on savings and dividends. I would like to get some facts on the record on that.

How much of the $3.4 billion of the 1981 revenues do you estimate is due to elimination of tax evasion and how much is due simply to faster payments to the Treasury?

Secretary MILLER. Mr. Chairman, let me give you a time sequence.

In the first year of withholding on interest and dividends, we estimate that there will be $3.4 billion, as you mentioned, increase in revenues. Of that, about $2.4 million would be timing, just collecting currently rather than the subsequent year, and $1 billion would be increased compliance. But as the system takes hold, the one-time shift in timing ends and then we begin to pick up additional revenues from compliance.

We expect that in 3 years we would be picking up $2½ billion a year from increased compliance through that technique. So it starts off with about $1 billion of increased compliance and builds up in 3 years to about $2½ billion.

EXEMPTIONS FROM INTEREST WITHHOLDING

Senator CHILES. What plans do you have to exempt people who would not have any tax liability? As you know, some 40 percent of interest is paid to people over the age of 65. For a lot of those people, the interest is about their only income and if they had to wait until the end of the year to get a refund, that would be tremendously harmful for those people because they are the greatest victims of inflation today.

Secretary MILLER. You are correct, Mr. Chairman. There are some overriding and competing considerations in proposing the withholding. One, of course, is consideration of the proposition that income from dividends and interest might be treated in the same way that wages and salaries are. On wages and salary, there is current withholding. Logically, there is no reason to treat another form of income differently. It would increase compliance and, therefore, be more equitable in that sense. But it does raise the issues of inconvenience and a difficulty for some taxpayers.

What we are going to propose as we are working out the details is a system for allowing declarations of individuals who do not expect to incur a tax liability from interest and dividends so there would not be withholding for those who file declarations.

We are also looking at the possibility of in some kinds of accounts, of having less frequent payments to the Treasury from withholding, perhaps at the end of the year, so that even where there is a question of tax liability, the withholding would be very near to the time of refunds, so the time between withholding and refund would be minimal.

We also are considering exempting corporations and dealers who are not out of compliance and where just the paperwork might be not worth the effort because we find high compliance with corporations and Government security dealers, we have good audit trails there. So I think we can balance the concern for the fair treatment of that type of income, improving compliance at a time when we think everybody should be paying the full taxes due and, yet, reduce the burden on those who otherwise would be inconvenienced by the withholding of cash which may not be actually due.

Senator CHILES. Well, then, you think some of our senior citizens who would not be receiving sufficient dividends would be able to make a declaration?

Secretary MILLER. Correct.

Senator CHILES. On the basis that their moneys would not be withheld?

Secretary MILLER. That is the plan we intend to propose to Congress.

PAPERWORK BURDEN FROM WITHHOLDING SYSTEM

Senator CHILES. How much paperwork is going to be involved in setting up this kind of a withholding system, and how do you expect to offset the cost to the private sector of the new reporting? And will that collection system require extra Treasury staff? Will you have to have additional people?

Secretary MILLER. You are correct, and on that score we were looking at areas, like these declarations exemptions, to avoid paperwork where we would all just be going in a circle, collecting money and giving it back.

The present system of reporting, that is, of filing information about dividends and interest, covers, we estimate, about 87 percent of the kinds of interest and dividends that would be subject to withholding. So we already have the paperwork done for the bulk of the kinds of income payments we are talking about.

The additional requirement of actually making the withholding and paying over to Treasury we estimate to be a relatively smaller administrative burden because of the already existing paper system of reporting. So it would just be the withholding and payment. We do not believe that would add great costs.

As you know, the employers and businesses of America now are set up to make withholdings in a number of areas, payroll taxes, withholding taxes and to file W–2 and 1099 forms. So I think the additional administrative burden will not be great.

Senator CHILES. Senator Schmitt.

ECONOMIC IMPACT OF WITHHOLDING PROGRAM

Senator SCHMITT. Mr. Secretary, on this subject, don't you think it would do the economy more good to let the public use the money for that year, rather than give it to the Government?

Secretary MILLER. Senator Schmitt, the problem is when you think of when the incidence of tax liability takes place, you have problems of equity that go the other way. To the extent the bulk of income for individuals, corporations is accounted for and paid currently, it is a little anomalous that another type of income, interest and dividend, is allowed to carry for 1 year, and when that results in underpayment of taxes, then I think all those people who don't have interest and dividends that are paying their withholding tax out of their salaries currently are greatly disadvantaged by another class of citizen getting a benefit and then not fully reporting and paying taxes.

I think when you begin to pick up $2½ billion a year from compliance and treat interest and dividends the same as we already treat the income of a machine operator or an accountant, that we are, I think, being equitable.

Senator SCHMITT. But you have to look at both sides of the ledger and I think the chairman is entirely right in bringing up the point of inconvenience and actual loss of income for those that are most dependent on savings and investment, those who are retired, generally the elderly. Also we are trying to get this economy moving again.

It seems that the administration, by their policies, are trying to drive the economy into stagnation and into recession.

We do have a recession now. We will get to that later. I just cannot see when you are already going to collect something like I believe $90 billion more taxes in fiscal year 1981 than we collected in fiscal year 1980, why you would be looking for every ounce of blood out of the turnip.

It seems to me at least in this case you would be willing to let the private sector utilize the fruits of their income, part of which is interest, before the Government gets a chance to utilize it.

Secretary MILLER. We can argue the same thing with other withholding.

Senator SCHMITT. That's for sure, but I'm not, I'm arguing about this one.

Secretary MILLER. I will argue equity, that it is unfair to allow this type of income to gain an advantage over another type.

Senator SCHMITT. We can introduce fairness into this economy until there isn't an economy. You are never going to have complete fairness, Mr. Secretary.

Secretary MILLER. As you know, Senator, the proposal is a long-term proposal. At the time this would be enacted and put in place, we would expect to be recovering from this recession so we should not forego a necessary improvement in our tax system because of any particular year that may be a recession.

Senator SCHMITT. Mr. Secretary, I would disagree with that completely. I think we have to look at how we are going to get this economy moving now. If we start taking every step that we can think of that might increase a little bit of tax revenue, we are going to end up going in the opposite direction.

Secretary MILLER. Senator, I cannot justify in my conscience to any American why we should, as a matter of economic policy, forego to collect taxes due from everyone who owes taxes. I don't think it is good economic policy to say we are going to help the economy by not collecting taxes that are due.

Senator SCHMITT. You will collect them at the proper time.

Secretary MILLER. We are not collecting them now.

Senator SCHMITT. Then that is a problem of enforcement.

Secretary MILLER. It would be very, much more extensive, much more burdensome to try to put in the system to pursue, find and collect these taxes when they are not reported. It is a simpler and more equitable system to require that this type of income be brought into compliance just like wages and salaries.

Senator SCHMITT. It might be simpler for the Department of Treasury, but I cannot believe it is going to be simpler for those people who have to withhold and take into account the fact their savings and interest are going to be withheld.

Secretary MILLER. Let me just repeat——

Senator SCHMITT. You ought to get out there and be retired at a marginal income, Mr. Secretary, and then start to think about what is going to happen to some of that savings income. Some of the questions asked are: what do I have to do, do I have to go get a lawyer, or an accountant to make sure this happens and I don't violate the law?

Secretary MILLER. I don't think, Senator, that that is the context in which this is presented. We are offering a simple system. We now have such mechanisms for declarations that will allow those who live on limited income not to ever have withholding.

INCOME LEVELS OF PEOPLE RECEIVING DIVIDENDS

I think you are mistaken to believe that the bulk of interest and dividends in America are paid to low-income people who are retired.

Senator SCHMITT. I didn't say that, but that is a large category of people.

Secretary MILLER. There are people who have substantial incomes who are not retired and those who have marginal incomes and are retired and don't have tax liability, we won't withhold.

Senator SCHMITT. But they are going to have to go through that whole mess: First, to find out about it and second to do something about it, making sure their interest income is not withheld. On top of that, we are dealing with an ever-decreasing rate of savings in this country. It is 3.4 percent, I think, right now, and compares extraordinarily unfavorably with the rest of the free world. And don't you believe that this is going to add to a further reduction in the incentive to save in this country?

Secretary MILLER. No, I don't think so. I think that really, if we believe that we should create incentives by letting people not pay their taxes, there is something wrong.

Senator SCHMITT. Mr. Secretary, I am not advocating the nonpayment of taxes. I am just saying, let's let the people work with that income rather than giving it to the Government on a withholding basis. You will get your taxes, if you have good enforcement, you will get your taxes. The worst thing you can do is make taxation more onerous so you get less voluntary compliance.

Secretary MILLER. There is not enough voluntary compliance in this area now. I might say no one suggests when a purchase is made and a sales tax is due, that we defer a sales tax for 1 year so the people can use the money. We never suggest when someone earns a salary that we should defer withholding tax and let it be collected 1 year later.

Why should this particular incident of tax, where income is earned and tax due, be allowed to be treated differently from the salary of someone who is in the low-income bracket and has money withheld from their weekly paycheck, which is far more critical for the support of the family than the income that would not be withheld from someone who doesn't have tax liability and only be withheld for someone who has tax liability.

Senator SCHMITT. There are a lot of sources of income that only get taxed at the end of the year. This is another one and savings investments have an entirely different function in our economy than does income.

To say that you have to try to treat everything identically is ridiculous, Mr. Secretary. They are all different parts of the economy. I think, though, the main thing is that the Treasury seems bound and determined to squeeze every drop of blood out of the American economy that it can when we ought to be doing just the opposite. We ought to be thinking of ways to get that income back into the marketplace, into the kind of things the American people can do best with it, rather than the Government.

Obviously we are not going to agree on this subject.

Senator CHILES. I was just wondering if you would repeat your question. I do not think you all are actually going to agree.

Secretary MILLER. Pardon me?

Senator CHILES. I don't think you all will come to agreement.

Secretary MILLER. I suspect we will have to disagree on this one. I hope that we will not characterize the Treasury, who has the mandate from Congress to collect the taxes due, I hope we will not characterize it as trying to squeeze blood from the economy when it suggests that it would be appropriate to collect the taxes that are due and we believe that this is a more efficient way to do it.

Senator SCHMITT. It is more efficient for the Treasury, it is not more efficient for the people.

Secretary MILLER. It is not fair to those who do not have investment income to result, for whatever reason, in an inadequate collection of taxes from those who do have that kind of income.

It adds to the burden of those who have no choice but to pay their taxes currently. I know it is a philosophical debate. I say to you when we present our proposal, we will endeavor as best we can to insure the taxes are not required to be withheld, nor is there a burden, for those who would not incur taxes, and, as I said, we are looking at the possibility in other cases of having the withholding occur at the end of the year so a refund could be achieved, if due, very promptly.

We are sensitive to that, Senator Schmitt.

Senator SCHMITT. If you were sensitive to it, Mr. Secretary, you would not propose it.

Secretary MILLER. We are sensitive to the problems you point out, but we also look at the opposite side and that is what it does cost the system that does have significant shortfalls in collecting revenues that will help reduce the burden for everyone.

Senator SCHMITT. Your basic justification is equity, it has nothing to do with revenues, is that correct?

Secretary MILLER. Pardon?

BASIC JUSTIFICATION FOR WITHHOLDING PROPOSAL

Senator SCHMITT. Your basic justification is somehow that this is more equitable.

Secretary MILLER. No, our basic proposition is that there is less compliance in paying taxes due on interest and dividends than there is on salaries and wages. We get about 98 percent compliance on salaries and wages. We get far less than that on dividends and income. We do not, through our enforcement procedures, know any way we can prove that without enormous——

Senator SCHMITT. Mr. Chairman, I was going to defer to you but I don't think those are accurate figures. You don't know about a lot of income that is earned in this country. So that 98 percent can't reflect the total income earned in this country. The 98 percent probably reflects what is reported income, either directly or indirectly; whereas all savings and investment income is reported in one way or another. It is a question of how good are you——

Senator CHILES. No; it is not reported either.

Senator SCHMITT. The records exist.

Senator CHILES. It is not reported.

Senator SCHMITT. But the records exist for savings and interest income.

Senator CHILES. No.

Secretary MILLER. It depends.

Senator CHILES. Shylocking is not reported.

Senator SCHMITT. I think, Mr. Chairman, compared to the——

UNREPORTED INCOME

Senator CHILES. The same thing as talking about a subterranean economy.

Senator SCHMITT. I would like the Secretary to make some estimates for us on what is the relative amount of underground income earned versus the relative amount of underground interest income earned.

Secretary MILLER. There is a considerable amount of unreported, so-called, interest.

Senator SCHMITT. But let's not say you have a 98-percent compliance in income earned other than interest income. I don't think that figure will hold up at all.

Secretary MILLER. I didn't say that, I said salaries and wages.

Senator SCHMITT. I will say salaries and wages, I don't think it is 98 percent. That is all you know you have records for.

Secretary MILLER. It depends on how you classify the subterranean accounting. Most of it is not salaries and wages, in my sense of the word. Because either legal or illegal trading, selling is not wages and salaries. So perhaps we have a semantics problem. The figure is very clear that we do not collect as high a percentage on the legitimate side of the economy of the legitimate interest and dividends in the legal sense as we do in the part of the economy of salaries and wages that operate in a legal sense.

Talking about the subterranean economy, I think we have all these factors, incomes of various types, that are slipping through us. There is no question.

Senator **SCHMITT**. Mr. Secretary, I will agree to disagree to disagree with you on that whole issue.

Thank you, Mr. Chairman.

INFLATION AND GOVERNMENT REGULATIONS

Senator **CHILES**. As Secretary of the Treasury, Mr. Secretary, your key link with the private business community, one concern I have with the anti-inflation package is whether it is broad enough to have credibility. I know when I talk about inflation with businessmen, they talk about regulations as much as they talk about balancing the budget. I have offered language as part of the budget resolution urging the President to declare a zero net inflation impact policy for regulations through the end of 1981.

What that would say is whenever you are about to issue a new regulation with a significant measurable cost, you would be required to offset it by reducing the cost of some existing regulations or reducing the regulations themselves.

In addition to setting a major piece of anti-inflation policy, I think this would force the agencies to look at their existing regulations, not just the new ones that they are adding. I find that most of the exercise that is going on is only looking at something that is new and our problem is we have thousands out there on the books that no longer are necessary or not necessary the way they are being done.

I would like to know what your opinion is of this kind of policy, both as to the substance and credibility it would add to our anti-inflation package.

Secretary **MILLER**. Mr. Chairman, I think your suggestion has merit. We have looked at this issue. There are some difficulties, but in principle, I think you are on the right track. The difficulty is there are new regulations being issued that are mandated by statute. As new statutes come along, there is to be a whole new body of regulation in connection with the new financial law that has just been passed. And it is not often possible to time the unwinding of other regulations. The President is pushing for the Regulatory Reform Act. He is pushing for deregulation. I think considerable progress has been made. More needs to be made. I am very much in sympathy with your suggestion.

I have not personally been as able to involve myself in the question of unwinding regulations at Treasury as I was at the Federal Reserve. There we had a project going on to try to examine every regulation and eliminate the ones not needed. I am sure we need to do this in every Department of Government.

HIGH INTEREST RATES

Senator **CHILES**. Obviously high interest rates are a key part of the program to slow down the economy and to some extent the Federal Reserve has deliberately raised the rates. To some extent it has just acknowledged the real rates of inflation and the uncertainty of the credit market. We certainly pay a high price for this kind of medicine and our high interest rates stop housing construction.

A lot of people are put out of work. We also get an inflationary effect because losing production of many units this year means less supply to meet next year's demand which, again, triggers an inflationary spiral.

The Treasury bill rates came down a little in the last 2 weeks. Do you feel that there is enough restoration of confidence by lenders that we can expect some real relief from high interest rates?

Secretary MILLER. Mr. Chairman, I believe we will in the coming months see reduction of pressure in credit markets, reduction in demand, reduction in inflationary expectations. It will be expected to see interest rates come down.

As you pointed out, they have come down a bit recently. We don't know whether that is a turning point or merely a short-term fluctuation, but I believe from the intensified initiatives taken by the President, by the effects of restraint in credit demand and the slack coming in the economy as various areas slow down, I believe we will see lower interest rates later in the year. What amount of reduction, I can't tell.

HOUSING AND INTEREST RATES

Senator CHILES. I understand it is very difficult. I wonder if there is any way you can make any kind of guess if we might see a reduction by as much as 2 percentage points in the fall.

My concern is whether the housing market could have time to recover for the heavy spring sales next year if there was a drop? Most people tell me that when that interest rate touched about 14 percent, that is when construction really shut down. It went on through 12, 12½, there was still some business in the range of 13 percent. When it touched 14, that was the end. It was in my State.

Senator SCHMITT. Also in mine.

Secretary MILLER. In the absence of some new external shock, some new oil shock, I think we will see a slack in pressure on rates. I believe we will see new opportunities for housing later in the year. I cannot, unfortunately, give you a precise prediction because of the tremendous uncertainty about how all this interacts.

We did not expect interest rates, the prime rate to get to 20 percent. There was an outbreak of demand for credit and an acceleration of activity in the first part of this year that was quite surprising. Part of it seemed to be a feeling that there was going to be some sort of restriction and sort of a rush in to borrow money for fear it would not be available and it drove rates up much higher than expected. That is why I hesitate to predict how quickly we will see them coming down.

I will say one thing, I never thought we would be looking to see 14 percent prime rate looks pretty good. If we go to 14 percent, it is better to go down than up.

ECONOMIC FACTORS FOR 1980'S

Senator CHILES. The administration is basing its revised budget on a forecast that the unemployment rates will creep up about 1 percent to 7.2 in 1980, stay at that level through 1981. CBO is slightly more pessimistic with a fiscal year 1981 average of 7.5 percent. I am concerned as to whether these kinds of steady-as-you-go predictions are realistic today. A year ago I thought they were because the indicators were moving at a gradual rate. Now it seems like the boom went on so long with consumers and businesses spending at a tremendous rate, we are setting up for a bust. Super inflation has created super interest rates and that has brought housing construction to a screeching halt, the automobile industry is in bad shape, and starting serious lay-offs and business and consumers seem to have finally gotten the message and they begin to cut back on their spending.

What do you see as the underlying factors of economic strength that will let the economy ride this one out with a mild recession instead of getting some kind of rapid downward spiral that we experienced in 1975, and how do we get people serious about cutting back without setting off a major panic?

Secretary MILLER. I think your point is well taken. There tends to be, when you have a high altitude in rise, you will have a high aptitude in fall-back. For a number of reasons, we have not had the buildup of inventories that we had back in 1973–74, which preceded the 1974–75 recession. There are perhaps lessons of that time. The inventory losses that were taken, the higher costs of carrying inventories, the better techniques of controlling, for some reason we have kept a better balance of relation of inventory and sales.

In a business cycle such as 1974–75, on the down side we had a double whammy because there is reduction in demand, excess inventories, production is cut lower. There is not a need to change demand, but to change to work off inventory. I think we can avoid that.

We are also missing another kind of inventory and that is the inventory of speculation in real estate. You recall real estate trusts had a great deal of excess properties built up, and overhanging the market, that created serious problems. We do not have that now. And even more important, I think there are some fundamental reasons why we are going to see opportunities for improvement in business fixed investment despite the slowdown. Some of those reasons are that the current price and cash flows that are going into the energy field and the business opportunities for the development of alternatve energy sources, domestic sources is probably going to trigger a good deal of activity in that area.

We also have a very important need for the automotive industry to speed up its retooling for fuel-efficient same in order to maintain its market share. This isn't a question anymore of putting it off based on the business cycle. The automobile companies need to move very positively in that direction because of the market demand for the fuel-efficient car that will be filled by foreign producers if not filled by domestic companies.

When you add up with the energy investment, the automotive investment, the supportive industries that will back those up, plus the inventory situation, I think you have a better mix in the economy than we had in 1974–75, a better balance and better opportunity for riding through this period with only moderate downturn.

LENDING

Senator CHILES. Part of the President's anti-inflation program is the implementation of voluntary programs to restrain excessive growth in loans by large banks and other lenders.

To your knowledge, what has been the initial reaction to the Federal Reserve program on restraining the growth of loans and other outstanding credits?

Secretary MILLER. Mr. Volcker has indicated to me, as I understand it, that the major banks which are the subject of the voluntary—special credit restraint programs, they call it, have been cooperating.

They are filing information on their loan activity. There is an effort to hold the growth of bank credit in those areas to a much lower rate of expansion than preceded this. It is early, of course. This has only been going on now for 4 weeks. As I understand it, there is a general understanding that this is in the mutual interest of financial institutions and the regulators and the Government. I believe there is cooperation.

We have seen some slack in demand for credit release institutions. Last week there was a blip upward. Over the 4 weeks, I think we have seen cooperation. I believe we will have cooperation with the Federal Reserve.

OIL

Senator CHILES. When you testified, last January, before the Senate Committee on the Budget, you were with Mr. McIntyre and Mr. Schultze. The administration's economic forecast called for real GNP growth of 2.8 percent and unemployment rate of 7.3, an increase of cost-of-living index of 8.6.

Since then we have been experiencing inflation rates approaching 20 percent on an annual base. The administration has revised its forecast for cost of living increase for fiscal year 1981. While you have increased our CPI projection from 11.8 to 13.9 for 1980, you have only come up from 9.2 to 9.5 for 1981. Do you think that we can really get a drop of 4.4 percent in 1 year and what happens if OPEC raises oil prices again, with the administration imposing oil import fees? Won't that give us another tremendous round of inflation?

Secretary MILLER. I am not sure the figures I have in mind are quite consistent with the ones you cited. I thought that fourth quarter, we were projecting 12.8 percent increase in CPI in 1980. Without looking at the specific numbers, let me kind of point out the ways in which we can see inflation rates change over the balance of this year and into next. It is true that if we have a major interruption of oil supplies, some major change in the world that would set off another oil price shock, then there is no way to gage that in advance.

Really, the only thing I can say about that is at the moment, the supply-demand relationships are much more comfortable. We have already absorbed a major decline in oil output from Iran. There has been a tremendous drop-off there in the last 15 months. We have seen some curtailment of production in a number of other countries and yet at the moment, the stocks in the world are quite—are the largest we have had on record. The production of oil is at least equal, slightly above final demand. So that condition is much better than we have seen it for a while. That does not mean we still can't have a problem.

But let me just point out how much of the recent inflation has been influenced by two factors. One is by the 125 percent increase in world oil prices over 14 months, and the second is the run-up in interest rates that reflect in mortgage interest rates in home financing that have a very big impact on CPI.

If the rates of increase in energy prices, which we have been seeing in recent months anywhere from 75 to 100 percent annual rate of increase month after month, if that just begins to taper off, as it appears to be, and that rate of increase drops down to 15 or 20 percent, that would knock multiple percentage points off of that CPI figure. And if at the same time we just didn't have any further increase in mortgage rates, just absorbing the interest, but we don't increase any more, that will begin to show up in a very major way in the CPI. Just those two factors alone can result in more than 2½ percent reduction in the CPI. That is assuming everything else stays in this relative position. That is not a very ambitious objective. That means you are still having very large increases in oil prices and that you are not making any headway in reducing interest rates. That being so, I think we could feel that it would be reasonable to pursue these policies to digest this tremendous run-up in energy and see that begin to attenuate, to see the turn of interest rates and some relief there and, therefore, see a rather substantial reduction in the run-up of the inflation as measured by CPI.

You must remember it ran up very quickly by special factors. As those special factors fade, it can fall back. The level to which it falls is still far too high, at least it will get us back to a level where we can begin to progressively push it down further and further on a multiyear basis until we have the kind of price stability we are all seeking.

Senator CHILES. Senator Schmitt?

UNFOUNDED OPTIMISM

Senator SCHMITT. Mr. Chairman, I appreciate all those extenuating factors, but there are some other factors that would argue the opposite conclusion. The Producer's Price Index is almost at a 20 percent rate of increase, the Federal Government in this fiscal year 1981 is going to spend at a record percentage of the gross national product, something over 22 percent.

There is a continuing deficit forecast in spite of the administration's projections. The 1981 deficit is approaching $50 billion. I personally don't believe that even with $90 billion in new taxes and a $14 or $15 billion cut in spending we are really going to balance the 1981 budget.

I would be very surprised if we did not have to deal with a supplemental of major proportions about this time next year. It seems to me all of those things suggest these optimistic forecasts of inflation abating and prime interest rates going down are unfounded.

Mr. Secretary, would you care to comment?

Secretary MILLER. Senator Schmitt, let me just comment on the various things you mention. The Producer's Price Index has shown high rates of inflation also as the CPI has. That includes very, very large increases in energy costs, that work in with all costs, not only the direct effect, but the indirect and secondary and tertiary effect. So we have the same opportunity there to begin to see——

Senator SCHMITT. Does that include tax increases, too?

Secretary MILLER. That would not include income tax.

Senator SCHMITT. No, business, corporate taxes.

Secretary MILLER. The income taxes, no, would not be in these numbers.

Senator SCHMITT. But I mean the cost of goods producers are putting on the market includes the taxes they have to pay, does it not?

Secretary MILLER. There has been no change in the rate of income taxes. If you mean the prices are raised——

Senator SCHMITT. There are new social security taxes.

Secretary MILLER. Social security taxes would be included.

Senator SCHMITT. There is no inflation generated by the windfall profit tax, or a 10 cent per gallon tax on imported oil? We have a number of tax inputs to that Producer Price Index, do we not?

Secretary MILLER. The windfall profit tax doesn't show up. The decontrol of oil will result in higher energy prices, to the extent we recognize the dilemma and need for us to move in a direction that increases conservation to reduce our dependence on foreign oil, and also resources to develop domestic. So we know we have an offsetting problem there which is why I did not suggset oil price increases might come down to some lower stable number.

We still are thinking of fairly high numbers. I am not suggesting there be a stabilization of world prices, but they drop from 100 percent to 15, 20, 25 percent, which would allow for the decontrol, allow for some oil price increases and not be optimistic but recognize between 1974 and 1979 there was really practically no increase in oil prices and then we had a 125-percent jump.

All I am suggesting is we can make some improvement even if we have 15- to 25-percent increases.

On the point of deficit Government spending, there is no question we need to make efforts which are being made in the Congress and the administration to reduce spending.

Let me point out today is April 15 and it is the period when we end the individual tax reporting season and we go into the second half at the fiscal year in which the cash demands of the Government are less, they are reduced just seasonally.

They are also reduced by the fact we have absorbed a great deal of budget implications in fiscal year 1980. So the credit demands of the Federal Government will be considerably less in the next 6 months than they were the past 6 months. Then the budget proposal the Congress is working on for fiscal year 1981, there will still be considerable less demand for credit in fiscal year 1981 than fiscal year 1980.

So we see the Federal Government reducing its credit demands and, therefore, freeing up those markets for the private sector, which means that along with the other restraints on credit availability and with the slow-down of the economy, we should have conditions where supply-demand relationship demands for funds should bring about reduced pressure and see some lower interest rates.

I am not suggesting a precipitous drop, as I was pointing out to the chairman a moment ago; all I am saying is we can make some progress in reducing these inflation numbers even if we don't see interest rates going higher.

BUDGET ASSUMPTIONS

Senator SCHMITT. Mr. Secretary, the only thing that bothers me is that the budget that has been submitted includes assumption for the growth in the product. We see a major turndown—you may call it minor—in my State and everywhere else it is major in housing, agriculture, and other durable goods that we buy on credit. I don't think you are going to see a 2.5 rate of growth in GNP so revenues are going to go down. It is a negative rate of growth at the present time. In addition, you are going to see unemployment go up, which is increasing demands on the Federal Treasury.

Your assumption in the budget of inflation rate, is clearly too low. All of these argue that there will be a major supplemental next year. We are going to have that pressure on the credit market begin again, even granting that it may have mitigated in recent weeks.

Secretary MILLER. Senator, the revenue and outlay forecasts we have made in the budget submission assume that fourth quarter 1979, fourth quarter 1980, there will be a minus 0.4 real growth in the economy. It assumes that in 1981, fourth quarter 1980 and fourth quarter 1981, there will be 2.2 percent positive growth. It assumes that unemployment by the fourth quarter of this year will be at 7½ percent and will rise the following year at—7¼ percent at the end of this year and rise to 7½ next year.

So it is with those factors included that we have projected the kind of revenues and outlays that are presented.

You are absolutely correct, if the forecast should be wrong in either direction, the numbers would change. The estimate is that these numbers are reasonable. We know that economic forecasting is perilous, particularly in times when we are operating in an environment which is unprecedented, in which our ability to predict human behavior and business behavior is imperfect, so we could be in error one way or the other.

At the moment there is no evidence, and the balance in the economy is such that where there has been a down turn in housing, down turn in automobiles, there still has been resilience recently in consumer spending. There are factors that would support business fixed investment particularly as credit markets become—less pressure on them—these will all be interacting factors.

I can only hope that the forecast we have turns out to be more accurate than the more pessimistic view you have. I cannot promise you we are perfect in this forecast.

Senator SCHMITT. My pessimistic view is based on the failure of the administration to be able to forecast any of these parameters 1 year in advance. I stated earlier the figures that we were given last year, they were off by greater than factors of two relative to 1980.

ACCURACY OF FORECASTS

Senator CHILES. That was a failure that not just the administration missed; every economist I know missed that, including CBO, and everybody we listened to. It wasn't just the administration.

Senator SCHMITT. There were some who felt those were——

Senator CHILES. There are always the dooms-day guys and they are right part of the time because there are dooms-days. The vast majority, even the conservative economists missed this one too.

Senator SCHMITT. Mr. Chairman, what I am getting at is we have not changed any major factors in the ecocomic situation that would suggest that they are going to be any more right this year than last year. That is what concerns me.

Secretary MILLER. I think all major econometric models, I think all major forecasters have been rather close together in their forecasting over the last couple of years, and it has been generally divergent from what happened. Look at Iran. There was a change in government in Iran. There was a reduction of output of oil of a very substantial amount and there was a 125-percent increase in oil prices which I don't believe any forecaster——

Senator SCHMITT. I don't think you can blame oil, Mr. Secretary. Other countries, major industrialized countries are importing a heck of a lot more oil, a lot more dependent——

Secretary MILLER. PPI in Japan is 35 percent annual rate of increase in the Wholesale Price Index because of that factor. Just the fact we haven't gotten caught up with statistics doesn't mean that same oil price increase isn't showing up in Japan. Germany, over 20 percent——

Senator SCHMITT. So your problem, these errors in projection, the high inflation rate, and high interest rates are all the result of the oil crisis?

ENERGY PRICE IMPACT ON INFLATION RATE

Secretary MILLER. Let me point out there has been only two times, despite 15 years to build up inflation caused by many things, by many things—listen, I am not saying that the 15 years of inflation problem running through Democratic and Republican administrations is the result of oil. I will point out to you in only 2 years in that whole period of time has there been double-digit inflation and each time it was directly attributable to major increases in oil prices.

Senator SCHMITT. And very, very large budget deficits.

Secretary MILLER. Two years had double-digit, neither one predicted, each one hit with an oil price shock. There were larger budget deficits in the 4 years before President Carter than the 3 years he has been in office. You cannot say there is some imperfection in the budget system that suddenly created this. It is a fact that in 1974, oil prices went up $6 or $7 a barrel and inflation went up to 12 percent. It is a fact that in 1979 oil prices went up $18 a barrel, $18 a barrel and inflation went up to 13 percent. Those are facts.

Senator SCHMITT. Then why don't we go about producing domestic oil, Mr. Secretary?

Secretary MILLER. We had two prior Presidents who felt that controlling the price of domestic oil and holding it at unrealistic levels was the solution. This President has decided to go with the market prices and give an opportunity to search for——

Senator SCHMITT. But discourage it by taxation.

Secretary MILLER. No; fairly sharing the unearned revenue from existing production and proposing that there be less burden on new production to give the incentive.

If we want to discuss it in these terms, I will be happy to discuss them with you. I am not here to point fingers, if you want to continue to point out the inability to forecast the Shah of Iran being—I will say those who preceded this administration were unable to forecast the oil boycott and the aftermath of that. I will point out that the wage and price controls put in in 1971 and 1973 were disastrous and we are paying more for beef today because we liquidated herds then, because we tried to control them. I am not here to be partisan.

Senator SCHMITT. Mr. Secretary, the Carter administration has had 4 years to do something about this and has, I think, failed on the record. I don't need to review that record for you. I would also say the Congress has to bear a great deal of the blame from administration to administration. The Congress has acquiesced in the policies, many of which were wrong. I have admitted and said many times they were wrong.

The point of this discussion is that I don't think this administration knows what is going to happen. You are guessing and you have not asked for sufficient budgetary restraint in fiscal year 1980 as well as fiscal year 1981 to make any significant difference on the basic economic parameters. At the same time, in spite of what you say, our energy policy is ashambles. Domestic energy production is getting nowhere under the policies of this administration which have been acquiesced to by the Congress. We have to bear more of the blame, really, than you do because we go along with it. Energy is a major factor of cost increases, but I don't think you can ignore the other major deep-seated root problems of our economy. That is the continuation of large Federal deficits, not that they weren't larger at other times, but they continue to be large.

The continuation of the increase of the share of the gross national product that the Federal Government taxes and then spends, these are fundamental basic problems that have nothing to do with the oil prices. And I do not see that we are changing in spite of the rhetoric to the contrary. I am on your side. I want to see them changed. I don't think we ought to go into this next year with blinders on and think that these very optimistic, tooth-fairy-like projections of what inflation and interest rates are going to do are going to be realistic. We had better assume the worst and do something in this budget cycle to basically get rid of those fundamental factors that are going to be there, whatever oil prices be.

Secretary MILLER. Senator, for the time I have been in Washington, we have been pursuing a series of fundamental policies to deal with inflation, which are sound——

Senator SCHMITT. But they haven't worked, Mr. Secretary. You had 4.8 percent in 1976 going down. It turned around. You had a GNP at almost 6 percent rate of growth going up. That turned around. Nothing has worked and you are trying to blame OPEC. I just don't think it will wash.

CBO FIGURES: IMPACT OF ENERGY PRICE ON INFLATION

Senator CHILES. I do want to put in the figures that CBO has done. If we are going to have a campaign thing here, we can do that. That can be our hearings, or we can elicit information for something. CBO points out in the Consumer Price Index of all items, November of 1979 to February of 1980, a 17.2 figure. Energy is 60 percent. Mortgage payments, 49.9 percent. Home purchase price is 10 percent. Food is 5.6 percent, and prices, excluding food, energy, and home purchases and finances is 8.8 percent. So that Comsumer Price Index, 80 percent of it being for energy, 49.9 percent being for your interest and your mortgage payments, you can't say that energy didn't have something to do with it.

[CLERK'S NOTE.—The table follows:]

INFLATION IN CONSUMER PRICES

[Percent change, seasonally adjusted annual rate]

	December 1977 to December 1978	December 1978 to November 1979	November 1979 to February 1980
Consumer Price Index, all items	9.0	13.1	17.2
Energy	8.0	38.2	60.0
Home purchase price	11.2	16.0	10.0
Mortgage payments	22.2	33.5	49.9
Mortgage interest rates	9.8	14.9	36.3
Food	11.8	9.5	5.6
Prices excluding food, energy, and home purchase and finance	6.5	7.3	8.8

Source: Report of the Committee on the Budget; First Concurrent Resolution on the Budget: Fiscal year 1981; p. 12.

Senator SCHMITT. Mr. Chairman, everything has something to do with it. This administration and this Congress has been on watch and they have blown it. All of those numbers that you read reflect these underlying problems in our basic policy, whether it is energy or tax or fiscal. They are all related. Those mortgage rates are going up because of basic fiscal policy, not because of energy policy.

The energy costs are going up because we refuse to produce our own.

Senator CHILES. Now I think you believe in the tooth fairy. If you think energy can go up 60 percent and that is not going to affect interest rates, then I have to think that you believe in the tooth fairy.

Senator SCHMITT. The basic pressure on interest rates, Mr. Chairman, is the borrowing by the Federal Government. Twenty percent of the credit is being used up by the Federal credit.

Senator CHILES. Jack, you are believing that stuff you read. [Laughter.]

Senator SCHMITT. You are believing the stuff you read.

Secretary MILLER. Let me just point out a fact. The fact is that the increased payments abroad to import oil this year, the increase will be as great as the increase in Federal borrowing. So you have got a factor there that is on a high order of magnitude.

We are moving as rapidly as we can to reduce the Federal needs for funds, but we cannot reduce the need for imported oil quickly.

The objective in reducing our dependence upon foreign oil is based upon hammering out national energy policies that are very, very difficult to develop because we have energy in this country where we have producers, consumers, parts of the country that have hydro power, we have parts of the country that have indigenous oil and gas readily available, we have coal, other parts of the country that have nothing.

The debate has gone on for decades as between the proper relationship between consumers and producers, whether the price should be controlled, the effort to hammer this out is difficult. It is like negotiating among a series of independent nations.

U.S. ENERGY PRIORITIES

Slowly, excruciating, difficult as it is, this policy is coming into play based upon four basic fundamental priorities. The first priority is to conserve energy. It is the surest, cleanest, safest way to reduce our dependence on foreign oil. This has been both through a series of incentives to make our whole economic system more energy-efficient, including weatherizing of homes, incentive for improving energy efficiency of business, requirements of mandated temperature controls, mandating fuel-efficient automobiles.

The result is we have reduced our imports of oil from the 1977 peak of all time at 8½ million barrels per day to something like 7.6 or 7.7 million barrels per day.

The second priority is to produce more domestic conventional oil, oil, gas, coal, nuclear. It has required this President to take the courageous step of decontrolling oil prices. Given the cash flow, the incentive, the opportunity to allow those who are willing to do so to seek and explore and develop energy, that is expensive. There's lots of energy in this land, but it is expensive to develop. It is deeper, it is offshore, it is in very difficult terrain, it is hard to find, it is difficult to produce. We have got to do that.

The third priority: Major effort in this next decade, greater than the Marshall Plan and the Apollo program, which you participated in combined to produce more domestic sources of unconventional energy—synthetic fuels. Hundreds of billions of dollars are going to be spent between now and 1990 to get oil from shale, to get oil from coal, to get gas from coal to find those hard-to-find and unconventional sources of natural gas to reduce our dependence upon foreign oil.

These policies are being put in place. They are almost there. We have the blackout utility bill yet to go. The rest of the proposals are through both Houses of Congress or in conference, or already passed.

The fourth priority, the development of renewable resources of energy, the solar, alcohol, and biomass. This is going to take a complete system of development over the next two decades. It is essential we keep on track and keep our national purpose and will. It has been hard to hammer out. Thanks to congressional action, thanks to Presidential leadership, we are on the way.

We will have a renaissance of investments in the decade of the eighties to pursue these objectives. In 1990 we will reduce our imported oil to some 4 to 5 million barrels per day. We can't do it by being divisive and pointing fingers. We are all at fault to be unwilling to face up to the realities of the energy situation 10 years ago. This Nation was built during the first 100 years of existence by renewable energy, water, wood, and wind.

That second century was built on fossil fuel, coal, and then oil. We built the highest standard of living in the world for the most number of people because we had abundant, seemingly inexhaustible supplies of inexpensive domestic energy, which we used instead of capital and labor to build a high standard of living, but we built the most inefficient energy system of any nation. Japan couldn't build that. They had to build tiny homes, tiny automobiles, nobody could have them except a few people. They had to build public transportation, they didn't have air-conditioning, their factories had to recycle all the heat back into the process—Germany, the same. We came to that day of reckoning. We have a bigger job to do; 6 percent of the world's people using 30 percent of its energy has a big job. We can do it. We will do it.

Senator SCHMITT. Mr. Secretary, that is a very beautiful view of the future, a reasonably accurate analysis of the past. However, the last 4 years has been on your watch.

Secretary MILLER. I have only been here 2 years.

Senator SCHMITT. You really want credit for everything that has happened in the last 2 years? I don't think you do. The problem is, and only time will resolve it, whether or not your projections for the future are any better than the projections you and this administration have made in the past. And those projections have been lousy, terrible. I hope you are right. I sincerely hope you are right, but I can't agree that you are, with the kind of policies that this administration is following. I think that you are dreaming, that you think the basic energy policy of this country is sound enough to make those things happen, that the basic economic policy of this country is sound enough to make those things happen, that the basic economic policy of this administration is sound enough to see the things that you suggest are going to happen in the next year will happen.

I don't think it will work, I am sorry. My crystal ball has some different numbers. Thank you, Mr. Chairman.

Senator CHILES. Thank you.

U.S. SAVINGS BONDS

Mr. Secretary, we read a great deal about the collapse of the bond market in the country and I have heard increasing accounts of difficulty being experienced by the U.S. savings bond programs. As these bonds only pay 7 percent, they are being cashed in at record rates.

The subcommittee has a supplemental pending before it from the Bureau of Public Debt needed to pay the fees for debts around the country for cashing savings bonds. I am told in addition to the supplemental now pending for the Bureau of Public Debt, the committee will soon be receiving a reprograming request for an additional $20 million. What is the prospect you see for the savings bond program and can it survive in this economic climate without increasing the yield rate on the savings bond?

Secretary MILLER. Mr. Chairman, we are going to have to change the savings bond program, in my opinion. Later this week I will be testifying before another committee and proposing to Congress that we remove the statutory ceiling on savings bond rate. We are now paying the statutory ceiling of 7 percent. What we would propose to do as an interim step is to take the ceiling off completely, require that any increase in the interest rate be approved by the President so that it would not just be the Treasury able to set it. Maybe Congress would want to look at that.

We feel we need the flexibility to move with this rapidly changing situation.

The savings bond program is a very important part of the debt management, a very stable part. It has represented about $80 billion of relatively longer maturities, while bonds are held for long periods of time, the average maturity is near 7 years, which is much higher than the average debt outstanding for the whole debt structure. So it is a very stable and important part.

Obviously when we have these heavy redemptions and have to replace it by borrowing in the short-term market, we are paying more interest.

So we will seek that authority.

As a second step, we will plan by the end of the year to perhaps take a longer look at whether we should make some structural changes in the program to provide a future program for a convenient, easy way for savers to participate in Government bonds that is still not inconsistent with maintaining cash flows of private depository institutions. First we need to take a corrective step and take a longer look at what might be done in decades ahead.

INTERNAL REVENUE SERVICE AUDITS

Senator CHILES. There are two matters relative to IRS that I would like to mention to you and ask you to comment on.

As you know, IRS released a subterranean economy report last year that showed unreported income is well in excess of $135 billion each year, and that the problem seems to be growing. In view of this trend, I have been concerned that IRS continues to reduce its audit coverage level. I notice for fiscal year 1981, again, IRS proposes to reduce the audit coverage level to slightly over 2 percent, down from 2.24 percent of 1 year ago.

The President's 1981 budget amendment proposals will reduce the audit coverage level in it even more. Do you believe that it is wise from the point of view of maintaining voluntary tax compliance to permit IRS to continue to reduce its audit coverage level?

Secretary MILLER. This is a bit of a concern. The IRS has a problem in prioritizing the use of its resources to carry out its missions. Obviously in the face of balancing between budgetary restraint in terms of the size of government, the size of budgets, and, on the other hand, trying to reach out and do all, carry out the full mission, there is a balancing.

The IRS must first, of course, process the tax claims and documents itself. They cannot neglect doing that because that is just the essential first step to make the process work. Then it must look at its remaining resources and allocate them in terms of audit and enforcement.

I think there has been, as you pointed out, some dropoff in the audit rate. We will undertake steps to see if we can find ways to improve that. I think it is a balancing situation and one that is hard to deal with in the short run, because of these other pressures.

I am sure we gain assistance in other areas, perhaps withholding on interest and dividends could help us by moving——

Senator CHILES. I understand there is always the problem when you are laying out cuts that everybody is supposed to take their cut and when you are reducing employment levels, you are looking everywhere to reduce those levels.

In the Budget Committee, we look at IRS and we look at the audit function, it is a revenue raiser. We know that every time we add people, and you know this, too, into the audit section, we are going to raise the money. So that person is going to weigh beyond what we pay for his salary. It seems to me at a time of restraint that we are talking about now should be a time that we ought to be adding employment, or adding to the audit coverage, or at least making sure we don't allow it to go below.

I am concerned when we see this subterranean economy report and it was explained as kind of being that way in the hearings we held, but it only covered a small portion of where lost revenue is. To be reducing audit coverage in the face of that—I know there is no magic figure. We used to talk, when I was first on this committee, we talked about a 3-percent coverage being the kind of reasonable level we should be looking for. I know there is no magic—any particular number and as you become more sophisticated in your collection methods, the greatest sources of this revenue and the greatest potential for collection is in certain spots and you want to go after that rather than chase down every individual who might not be reporting their full income.

It is alarming to me to see that you are reducing overall coverage at a time that you are having a subterranean economy build the way we are seeing that happen in this country.

Secretary MILLER. Mr. Chairman, I just point out I don't disagree with what you are saying. We are trying to balance these things. I would say being aware of this with the budget that we presented in tables I and II that are attached to my testimony, you see that we have allocated program increases and personnel increases in the IRS and the greatest area of personnel increase is in investigations and collections where we are adding 1,664 positions and taking positions out of this to change the attitude there, and once again have IRS be playing the kind of role that it used to play, and I think the people expect and demand that it play in trying to work in these major organized crime areas.

IRS STOPS PURSUIT OF DRUG TRAFFICKERS

Another matter that concerns me is that IRS has all but given up on the war against organized crime and drug traffickers. While approximately 70 percent of the illegal portion of subterranean economy is the result of drugs, only about 8 percent of IRS' Criminal Enforcement Division resources are focused on apprehending drug traffickers. What can we do about this?

Secretary MILLER. This is an important subject. I understand that Commissioner Kurtz does have a study going on this very point. It is in process so I don't know where it stands at the moment. He will be here testifying, I believe, next week. It might be worthwhile to have him report to you at that time.

Senator CHILES. I am going to be here, too.

Secretary MILLER. We are aware of the problem and are working with the Department of Justice. He is taking a hard look at it.

I suggest he give you an update when he is here.

Senator CHILES. I would like very much to have your personal attention in this.

Secretary MILLER. It is important.

Senator CHILES. I think it is very, very necessary.

CUSTOMS DRUG TRAFFIC

Senator SCHMITT. Mr. Chairman, if you would yield, I know we agree on this subject and also with respect to the Customs activity and whether that really is either funded or organized in a way that is supportive of solving the problems in drug traffic throughout the country, particularly across our borders. So I hope maybe Commissioner Kurtz and the Customs Service can work together in this presentation.

Secretary MILLER. Yes.

Senator SCHMITT. And make sure that is being coordinated because there is an interrelationship there.

Senator SCHMITT. Let me just ask one final question and we will also have questions for the record.

TAX SIMPLIFICATION

What is the status of your tax simplification efforts? Don't you have an ongoing study to see what can be done to simplify the tax code? That is a major part of the compliance problem, I think.

Secretary MILLER. Yes. We have simplification not only of that, but we are also looking at the continuing whole way in which taxes can be collected. I am not sure I have any affirmative report to give you this morning in that regard. It is an ongoing subject.

Senator SCHMITT. When could we expect Treasury to make some specific proposals? We talked about equity a while ago. It seems to me most of the inequities exist in the existing code.

Secretary MILLER. I do not know that we have a timetable on that.

Senator SCHMITT. Can you supply that for the record, the status and some timeframe the Congress will have reports and recommendations to act upon? There are proposals floating around having to do with the IRS becoming far more than it is today, the debt collection agency of the Government. Do you have any brief thoughts on the advisability of that happening and could you provide other information for the record?

Secretary MILLER. Yes, we will.

[The information follows:]

The Treasury is continuously studying the tax system to make it more simple. These efforts extend to all aspects of tax administration, from tax return design to promulgation of regulations.

The Revenue Act of 1978 (section 551) requires the Secretary of the Treasury to conduct a simplification investigation with respect to tax code provisions and income tax forms and instructions. A report with recommendations is required by November 1980.

The Tax Reform Act of 1976 had required the Joint Committee on Taxation to conduct a study on simplifying the tax law. This study was completed and a report entitled "Issues in Simplification of the Income Tax Laws" was issued in September 1977. The joint committee made a comprehensive survey of the income tax provisions and identified complexities. But at the same time the joint committee pointed out the conflict simplification has with other tax policy goals such as equity, social policy, and economic policy. The staff did not make recommendations.

Building on the joint committee's basic and comprehensive review, the Treasury is now studying which code provisions warrant early legislation to simplify them. The Treasury will make its recommendations to the Congress in November 1980.

Secretary MILLER. The first priority, of course, is to be sure we are collecting the taxes. There has been some problems in that regard in terms of resources. We have a program that I mentioned in my initial comments about trying to step up the collection effort.

Senator SCHMITT. There are some "friends" in the Congress who would like to see the IRS begin to collect debts for other agencies.

Secretary MILLER. I think the IRS ought to stick to its own niche where it has a lot to do in this field before it takes on new responsibilities.

Senator SCHMITT. Thank you, Mr. Secretary.

Senator CHILES. Mr. Secretary, we may have additional questions for the record.

We thank you very much.

GENERAL ACCOUNTING OFFICE

STATEMENT OF ALLEN VOSS, DIRECTOR, GENERAL GOVERNMENT DIVISION

Senator CHILES. One of the major issues the committee would like to focus on now, going into the Inspector General function of Treasury, is the adequacy of the Inspector General function at Treasury. The office currently has approximately 21 people assigned to it. Included in this total are only 3 investigators and 10 auditors for the entire Department that compares to 575 positions assigned to the Inspector General operation at the General Services Administration.

The Treasury Department is one of the few major departments which does not have a statutory Inspector General. The authority and responsibility of the Inspector General at Treasury is very different than that from a statutory Inspector General.

At Treasury, the Inspector General does not have the institutional independence of a statutory Inspector General, he has substantially less control over audit and investigative staff resources throughout the Department, he must generally rely on the bureaus to initiate proactive programs. He does not have subpena authority. He cannot offer the same assurance of confidentiality to a complainant, nor does he issue periodic reports to the Congress covering problems, deficiencies, and recommendations for improvement and progress on the implementation of corrective measures as envisioned by the Inspector General Act.

Almost all of the internal audit and investigative work done at Treasury is done by the individual agencies that are part of Treasury. Internal audit and investigative activities are considered as tools of the bureau and not within the province of the overall Treasury management. Recent allegations of briberies of Customs and ATF officials and the duplicative check problems have raised new questions as to whether the Inspector General function at Treasury needs to be substantially strengthened.

The next witness who will speak on this overall subject is Mr. Allen Voss, the Director of the General Government Division at GAO.

Mr. Voss, because of the interest of time, we are going to put your full statement in the record and then I want to really go to your closing observations on it.

I want to thank you, first, for your report. I think it is very thorough and very complete. We have read it and studied it.

GAO REPORT SUMMARIZED

I notice that you say you do not believe the internal audit and investigative staffs of the various bureaus can serve two masters. This is your closing observations and, second, no Treasury mandate specifies the extent to which the Inspector General is to take the lead in Department-wide efforts to assess the effectiveness, efficiency, and the economy of the bureau operations to eliminate fraud, abuse, waste, employee integrity problems, and mismanagement of Treasury programs.

Third, the resources to be provided to the Office of Inspector General are so minimal that it is hard to visualize the Office being an effective organization.

You go on to say you supported the need for centralized audit activities at the highest level of the Federal Government. To further this regard, the internal audit organization at Treasury should be removed from officials directly responsible for programs and operations and where that happens, the more the internal audit component can be independent and objective.

Accordingly, with the possible exception of the Internal Revenue Service, GAO is supporting the need to centralize the internal audit and investigative activities of the Treasury Department under the Inspector General who reports directly to the Secretary of Treasury.

IRS EXEMPTION

Why do you exempt IRS from that?

Mr. Voss. I guess I am a little bit on the conservative side, Mr. Chairman. Let me just mention, the Inspector General in any IRS investigation first has to get clearance from the national office of the Internal Revenue Service to gain access to tax returns. That is part of the procedures now of the Internal Revenue Service, to be certain that the work the Inspector General does would be work dealing with tax administration.

My reason for being conservative is that I have not met with Commissioner Kurtz. I don't know what the procedure really means, and I am not too sure whether the procedure puts any roadblocks right now in the Inspector General's access.

If the Inspector General has no roadblocks, I think that IRS should be centralized, also.

Senator Chiles. Generally speaking, is one of your reasons that the Internal Revenue Service, IRS, has, over the years, what has been reputed to be a very good internal audit and investigative department, has had a good reputation for doing a good job in that area?

Mr. Voss. I agree they are very good, but that is not one of the reasons. I still feel that a centralized office taking care of IRS work would be better than having it at the IRS level. It would allow the centralized office to look at the IRS policies and regulations much more independently than an internal audit group that is reporting directly to an IRS commissioner.

Senator Chiles. In other words, your reluctance relates to a taxpayer's return, but not to seeing the function of the overall agency. Is that what you are saying?

Mr. Voss. In fact, that may be the thing I am most concerned about. I do not think the Inspector General can do the right job without seeing the individual tax returns. He should not be allowed to disclose names of individual taxpayers, I agree. But if I want to do an audit on matching, I would question how well does IRS do its matching program. To do so requires seeing a certain number of tax returns.

You have to do that in order to take a look at the program.

Senator CHILES. I remember there was a time when IRS did not feel the GAO should even be able to look at IRS and Congress had to change that.

Mr. VOSS. Before we were allowed to look at tax returns, we could not make any audits of tax programs in IRS. Now we do make audits of the tax administration programs at IRS. In order to do that, we have to see returns.

GAO REPORT CONCLUSIONS

Senator CHILES. The gist of your report, as I see it, is here we have got an Inspector General of Treasury who has no troops, who has very little command authority, and yet he is supposed to be in name an Inspector General. He is operating without resources, troops, or authority.

Mr. VOSS. The Inspector General does have, and this is another part that makes the present setup almost an anomaly, the heads of the various bureau audit and inspection services now report to him as well as the head of the agency.

Any time you deal with multiple managements, there is bound to be a problem.

USE OF DETAILEES

Senator CHILES. I also understand from your report, then, what you are saying is in some instances he has loan personnel and those personnel he has loaned for a project, they have to go right back and work in the area and be under the authority of where they work under. So certainly that is going to hurt as far as what kind of job they can do and also even with the so-called troops he has down in that area, their salary is set, their promotion schedule is set, and they have to report directly to who that agency or division head is as well as the Inspector General, and you are saying that is an anomaly.

Mr. VOSS. I think that will, in the long run, cause serious problems. I just don't see a person being able to serve two masters, potentially with a conflict of interest, too. If you take people out of a particular agency, put them at the Inspector General level for one or two audits and drop them back to that agency, it is very difficult to be independent under those circumstances.

PREPARED STATEMENT

Senator CHILES. I think the work you have done points out the problems very clearly. We want to thank you very much for your report. I think it will be very helpful to us.

Mr. VOSS. Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF ALLEN R. VOSS

I appreciate the opportunity to appear before you today to present our views on centralizing the Treasury Department's internal auditing and investigative activities.

As you know, the Congress has long recognized the useful role of internal audit activities. The Budget and Accounting Act of 1950 required the heads of executive agencies to establish and maintain effective internal control systems over all agency funds, property, and other assets, including appropriate internal audit.

We consistently find that the internal audit function strengthens the management of Government programs and activities. In an organization as administratively complex as a Federal department, the internal audit function can funnel to management information which is widely dispersed throughout the organization. A management thus informed can better administer its multiplicity of programs and activities.

To upgrade and strengthen internal auditing, we have issued numerous reports recommending, among other things, the centralization of internal auditing activities within departments. Similarly, the House Committee on Government Operations reported that "There must be a central internal audit system in every large department or agency organized independent of department or agency operations."

In 1978, the Congress passed the Inspector General Act centralizing internal audit and investigative activities at 12 major agencies or departments. The centralization was intended to enable these departments to more effectively combat fraud, abuse, waste, and mismanagement in their programs.

We strongly supported this act because we felt that the establishment of a single unit reporting to the department head:

--Provided the advantages of greater independence.

--Fostered a broad viewpoint on the interrelationship of organizations and functions within an agency.

--Placed the internal auditor in a better position to make systematic and independent evaluations of and reports on all agency programs, activities, and operations.

A single unit also helps to attract and retain better managerial and staff capability, use staff more effectively, and better coordinate audit effort and interrelated findings. In addition, under unified direction and supervision, a single unit permits an organization to devote a greater portion of total staff time to audits and provides greater opportunities for tailoring staff assignments to staff members' talents and experience.

The arguments given for centralizing internal audit are also true for centralizing internal investigative activities. Further, we believe that having the audit and investigative functions reporting directly to top department management strengthens the internal controls within Federal departments. We also believe that combining the audit and investigative functions could result in a more concentrated effort to ferret out fraud and abuse.

TREASURY'S INTERNAL AUDITING AND INVESTIGATIVE ACTIVITIES

Most of Treasury's internal auditing and investigative activities are conducted by audit staffs located in 10 bureaus and by investigative staffs located in 4 bureaus. Attached to my statement are a series of exhibits that highlight, by bureau, the resources devoted to internal audit and investigative activities and the results of these activities. In summary, Treasury bureaus have devoted varying degrees of resources to these activities with varying degrees of achievement.

On July 18, 1978, Treasury established the Office of the Inspector General. The Office was conceived as a three-professional staff office chartered to

--report directly to the Deputy Secretary,

--supervise the investigation of allegations concerning high-level Treasury officials,

--coordinate but not duplicate the work of the bureaus' investigative components, and

--provide investigative services to bureaus not having an investigative component.

Also, the Inspector General was authorized to review bureau operations for ascertaining, reporting, and investigating employee misconduct. The Office began operations in September 1978.

To carry out his responsibilities, the Inspector General was authorized to detail investigators from bureaus having internal investigative components. In fiscal year 1979, the Inspector General obtained about 18 investigative staff years from the bureaus. For fiscal year 1980, Treasury increased the Inspector General's staff by two professional positions--one investigator and one management analyst.

Working with limited staff and authority, augmented by detailed staff, the Inspector General has taken several steps to increase Treasury-wide attention to waste, fraud, abuse, and employee integrity matters. However, it was evident to the Inspector General that Treasury's internal audit and investigative program needed immediate strengthening, including additional Department oversight and control.

As a result of an Inspector General study, Treasury's Office of Audit was consolidated into the Office of the Inspector General by Treasury Order dated February 20, 1980, and the Inspector General's authority was substantially expanded by Treasury Order dated February 27, 1980. The

Inspector General was assigned the following additional authority to:

- --Review and approve bureau internal audit and investigative plans.
- --Evaluate bureau internal audit and investigative programs.
- --Analyze reports to inform the Secretary or Deputy Secretary of any significant problems, abuses, or deficiencies disclosed in bureau audits and investigations and of corrective actions taken.

In addition, the bureaus are to consult with the Inspector General in recruiting and selecting bureau officials in charge of their internal audit and investigative components.

Much of the Inspector General's increased authority has not yet been implemented. For instance, the Inspector General has not yet become involved in the planning process, and no directives have been sent to the bureaus concerning reporting responsibilities. Concerning program oversight, the Inspector General has not developed an information system to monitor the various bureaus' efforts, problems, or accomplishments.

CLOSING OBSERVATION

In closing, several steps have been taken which can result in superimposing Department controls over the internal audit and investigative activities of the various bureaus. These steps present a dual management arrangement which is inherently subject to problems.

First, we do not believe that the internal audit and investigative staffs of the various bureaus can serve two masters.

Second, no Treasury mandate specifies the extent to which the Inspector General is to take the lead in Department-wide efforts to assess the effectiveness, efficiency, and economy of bureau operations or eliminate fraud, abuse, waste, employee integrity problems, and mismanagement in Treasury programs.

Third, the resources to be provided to the Office of the Inspector General are so minimal that it is difficult to visualize such an office being an effective organization.

For many years we have strongly supported the need for centralizing internal audit activities at the highest level in a Federal department. In this regard, the further the internal audit organization is removed from officials directly responsible for programs and operations, the more the internal audit component can be independent and objective.

Accordingly, with the possible exception of the Internal Revenue Service, we support the need to centralize the internal audit and investigative activities of the Treasury Department under an Inspector General who reports directly to the Secretary of the Treasury.

I am prompted to suggest that IRS be excepted from such centralization because of the sensitivity of its internal auditing operations, which require access to tax returns. However, we have not considered the matter in sufficient depth to enable us to support such an exception. We believe that justification for this exception, if desirable, should be provided by the Commissioner of the Internal Revenue Service.

This completes my statement, Mr. Chairman. We will be pleased to answer any questions you may have.

EXHIBIT I

Comparison of Internal Investigative Budgets With Total Treasury Operating Budget Fiscal Year 1979

Bureau	Investigative unit		Total bureau		Investigative unit as a % of total bureau	
	Staff	Budget (millions)	Staff	Operating budget (millions)	Staff	Budget
Office of the Inspector General (note a)	5	$ .2	9,412	$ 1,021.1	.1	-
Internal Revenue Service	547	14.7	72,427	2,155.3	.8	.7
Customs Service	104	4.0	14,470	442.9	.7	.9
Alcohol, Tobacco and Firearms	21	1.1	3,799	137.9	.6	.8
Secret Service	23	1.2	3,561	140.9	.6	.9
Comptroller of the Currency (note c)	-	-	3,123	b/96.6	-	-
Engraving and Printing (note c)	-	-	3,089	b/135.1	-	-
Total	700	$ 21.2	109,881	$ 4,129.8	.6	.5

a/Represents the operating budgets of the bureaus that do not have investigative components.

b/Total obligations.

c/Investigative staffs not operational during fiscal year 1979.

EXHIBIT II

Treasury Internal Investigative Staff by Activity
Fiscal Year 1979

	Professional Staff Years by Activity			
Bureau	Investigations	Systems vulnerability evaluations	Other (note b)	Total
Office of the Inspector General	a/20	-	1	21
Internal Revenue Service	181	-	209	390
Customs Service	52	-	29	81
Alcohol, Tobacco and Firearms	14	2	1	17
Secret Service	5	-	14	19
Total	272	2	254	528
Percentages	51.5	.4	48.1	100

a/Includes 15 staff years detailed from IRS and an estimated 3 staff years from Secret Service; Customs; and Alcohol, Tobacco and Firearms.

b/Includes staff years spent on employee background investigations, administrative support activities, equal employment opportunity matters, and program inspection activities.

EXHIBIT III

Treasury Internal Investigation Program
Workload and Accomplishments
Fiscal Year 1979

	OIG	IRS	Customs	AT&F	Secret Service	Total
Overall workload						
Investigations ongoing (previous fiscal year)	4	1,334	132	56	4	1,530
Investigations initiated	54	2,125	584	113	35	2,911
Investigations ongoing (year end)	(19)	(1,202)	(176)	(71)	(4)	(1,472)
Investigations completed	39	2,257	540	98	35	2,969
Fiscal year investigation results						
Referral to Justice	8	265	36	98	0	407
Referral for administrative action	18	568	314	0	18	918
Allegation not supported	13	1,424	190	0	17	1,644
Total	39	2,257	540	98	35	2,969
Justice referral results						
Not accepted	7	179	25	98	0	309
Convictions obtained	0	72	11	0	0	83
Pending	1	14	0	0	0	15
Total	8	265	36	98	0	407
Administrative referral results						
Employee reprimands or suspensions	2	140	93	0	0	235
Employee resignations or removals	2	77	57	4	0	140
Other employee actions	5	0	4	19	0	28
Program changes	4	0	21	0	0	25
No action taken	10	170	164	10	0	354
Unknown	2	360	0	65	18	445
Total	25	747	339	98	18	1,227

EXHIBIT IV

Comparison of Internal Auditing Budgets With Total Treasury Operating Budget Fiscal Year 1979

	Internal auditing		Total bureau		Internal auditing as a % of total bureau	
Bureau	Staff	Budget (millions)	Staff	Operating budget (millions)	Staff	Budget
Office of Audit (note a)	17	$ .55	1,627	$ 60.6	1.0	.9
Internal Revenue Service	452	12.98	72,427	2,155.3	.6	.6
Customs Service	103	3.55	14,470	442.9	.7	.8
Alcohol, Tobacco and Firearms	24	.81	3,799	137.9	.6	.6
Secret Service	2	.06	3,561	140.9	.1	--
Comptroller of the Currency	4	.09	3,123	b/ 96.6	.1	.1
Engraving and Printing	22	.63	3,089	b/135.1	.7	.5
Public Debt	26	.62	2,602	171.0	1.0	.4
Government Financial Operations	36	1.17	2,510	728.5	1.4	.2
Mint	21	.53	2,376	46.0	.9	1.2
Federal Law Enforcement Center (note c)	--	--	297	15.0	--	--
Total	707	$ 20.99	109,881	$ 4,129.8	.6	.5

a/Represents the operating budgets of the bureaus in which the Office of Audit has auditing responsibilities.

b/Total obligations.

c/Audit staff not established until February 1980.

By Activity And Results
Fiscal Year 1979

Bureau	Professional Staff Years By Activity Financial Compliance	Economy, Efficiency and Effectiveness	Evaluation of Internal Controls For Vulnerability to Fraud	Investigations of Fraud, Abuse, Waste & Error	Other	Total	Audit Reports Issued	Staff Years Per Audit Report	Savings from Audit Recommendations ($000)
Office of Audit	7.0	2.4	0	0	4.6	14.0	15	.93	0
Internal Revenue Service (IRS)	114.0	149.0	67.0	36.0	37.0	403.0	98	4.11	302,000
Customs Service	22.0	41.0	10.0	0	17.0	90.0	141	.64	14,197
Government Financial Operations	17.0	3.0	4.0	1.0	7.0	32.0	73	.44	12
Public Debt	12.0	11.0	0	0	1.0	24.0	36	.67	0
Alcohol, Tobacco and Firearms	4.5	5.4	5.9	0	4.2	20.0	10	2.00	164
Bureau of Engraving and Printing	9.0	4.0	5.0	0	2.0	20.0	54	.37	799
Bureau of the Mint	9.0	4.0	1.0	0	2.0	16.0	14	1.14	0
Comptroller of the Currency	1.0	.5	.5	0	1.0	3.0	4	.75	0
Secret Service	.5	.5	.5	.5	0	2.0	2	1.0	0
Federal Law Enforcement Center	Audit staff not established until February 1980.								
Total	196.0	220.8	93.9	37.5	75.8	624.0	447	1.40	317,172

EXHIBIT V

DEPARTMENT OF THE TREASURY

Office of the Secretary

TATEMENTS OF:

LEON WIGRIZER, INSPECTOR GENERAL

W. J. McDONALD, ASSISTANT SECRETARY FOR ADMINISTRATION

Senator Chiles. The subcommittee will now receive testimony from ne Office of the Secretary regarding the fiscal year 1981 budget request nd the fiscal year 1980 supplemental request.

Mr. McDonald, before we receive your testimony in support of the udget request, I would like to continue our discussion regarding the ffice of the Inspector General at the Department. I don't know hether you would have a statement on that.

Mr. McDonald. Yes, sir, I do.

Let me introduce the Treasury Department Inspector General, Mr. eon Wigrizer. Mr. Wigrizer will have a speech first and will comment n what we have achieved to date with the resources that we presently ve. I will follow his statement.

PREPARED STATEMENT

Senator Chiles. Because of our time situation, I am going to ask all you to summarize your statements. I will put them all in full in the ord. I hope you brief them for us.

The statement follows:]

STATEMENT OF LEON G. WIGRIZER

I WOULD LIKE TO BEGIN BY BRIEFLY DESCRIBING SOME OF OUR ACCOMPLISHMENTS AND OPERATIONS SINCE WE STARTED IN SEPTEMBER OF 1978. IN THE COURSE OF THIS REVIEW SOME OF THE ISSUES RAISED BY THE GENERAL ACCOUNTING OFFICE WILL BE DISCUSSED.

FIRST, WE HAVE CONDUCTED OR DIRECTED 198 INVESTIGATIONS INVOLVING 11 BUREAUS AND THE OFFICE OF THE SECRETARY. A NON-EXCLUSIVE SAMPLING OF THESE INVESTIGATIONS SHOWS THAT THEY INCLUDED ALLEGATIONS OF CONFLICT OF INTEREST; SECURITY VIOLATIONS; FALSE OVERTIME CLAIMS; FALSE TIME AND ATTENDANCE RECORDS; ACCEPTANCE OF UNLAWFUL GRATUITIES; OUTSIDE INTERFERENCE IN OFFICIAL MATTERS; AND SEXUAL HARASSMENT. FINDINGS OF THESE INVESTIGATIONS HAVE RESULTED IN INDICTMENTS IN FEDERAL COURT; TRANSFERS, REMOVALS, DOWNGRADING AS WELL AS EXONERATION OF EMPLOYEES; AND SUSPENSION OF A SECURITY CLEARANCE.

AS A FURTHER RESULT OF THE INVESTIGATIONS CONDUCTED, RECOMMENDATIONS HAVE BEEN MADE BY THIS OFFICE TO APPROPRIATE MANAGEMENT OFFICIALS WHICH HAVE RESULTED IN CHANGES IN OPERATIONS, PROCEDURES AND REGULATIONS IN VARIOUS TREASURY OFFICES AND BUREAUS. AMONG THESE HAVE BEEN CHANGES IN PROCUREMENT PROCEDURES; IMPROVEMENTS IN PHYSICAL AND DOCUMENT SECURITY PROCEDURES; TRAINING IN THE HANDLING OF FUNDS AND IN PREPARATION OF VOUCHERS; AND CLARIFICATION OF DEFINITIONS IN REGULATIONS.

SECOND, IN CARRYING OUT OUR RESPONSIBILITY TO REVIEW AND ASSESS THE POLICIES, PROCEDURES AND OPERATIONS OF THOSE BUREAUS DOING INTERNAL INSPECTIONS, WE HAVE CONDUCTED OVERSIGHT REVIEWS OF THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS, CUSTOMS SERVICE AND SECRET SERVICE INSPECTION UNITS. AS A RESULT OF OUR OVERSIGHT REVIEW, THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS, OFFICE OF INTERNAL AFFAIRS, HAS BEEN REORGANIZED. WE ALSO ASSISTED CUSTOMS IN REORGANIZING ITS OFFICE OF MANAGEMENT

INTEGRITY; RECOMMENDED TO AND ASSISTED THE BUREAU OF ENGRAVING AND PRINTING, AND THE OFFICE OF THE COMPTROLLER OF THE CURRENCY IN ESTABLISHING THEIR OWN INSPECTION UNITS; AND REVIEWED ANOTHER BUREAU INTEGRITY PROGRAM TO DETERMINE THE ADVISABILITY OF ESTABLISHING AN INTERNAL INSPECTION OPERATION IN THAT BUREAU.

THIRD, IN AN EFFORT TO MAKE KNOWN TO OFFICIALS AND EMPLOYEES THE EXISTENCE AND FUNCTIONS OF THE INSPECTOR GENERAL'S OFFICE, AND THEIR RESPONSIBILITIES IN RELATION TO OUR OFFICE, I HAVE MET PERSONALLY WITH ALL BUREAU HEADS AND THEIR TOP MANAGERS; WE HAVE DISTRIBUTED INTEGRITY AWARENESS POSTERS THROUGHOUT THE DEPARTMENT; AND HAVE HAD NOTICES SENT TO ALL EMPLOYEES OF THE DEPARTMENT REMINDING THEM OF THEIR RESPONSIBILITIES TO REPORT MISCONDUCT TO THE INSPECTOR GENERAL.

FOURTH, AS PART OF OUR ROLE IN ESTABLISHING INTEGRITY AWARENESS THROUGHOUT THE DEPARTMENT, AND IN DEVELOPING PROACTIVE PROGRAMS TO IDENTIFY AND ELIMINATE WASTE, FRAUD AND ABUSE, MEMBERS OF MY STAFF HAVE BEEN WORKING WITH TOP BUREAU OFFICIALS TO DISCUSS INTEGRITY TRAINING FOR EMPLOYEES AS WELL AS THE ESTABLISHMENT OF PROGRAMS IN EACH BUREAU TO EVALUATE AND IMPROVE INTERNAL CONTROLS. WE HAVE ALSO ASSISTED TWO BUREAUS IN THE PREPARATION OF LETTERS TO INDUSTRY REPRESENTATIVES AND TREASURY EMPLOYEES REMINDING THEM OF THE PROHIBITION AGAINST THE GIVING AND RECEIVING OF GRATUITIES; HAVE CONDUCTED A TRAINING SEMINAR FOR ALL BUREAUS IN THE PREPARATION OF CIVIL CASES IN MATTERS INVOLVING FRAUD AND CORRUPTION; AND HAVE BEEN WORKING WITH THE OFFICE OF GENERAL COUNSEL TO REVISE AND CLARIFY THE DEPARTMENT'S RULES OF CONDUCT.

SINCE THE OFFICE OF AUDIT BECAME A PART OF THE OFFICE OF THE INSPECTOR GENERAL, IT HAS BEGUN TO REDIRECT ITS AUDIT EFFORTS. IT IS ENHANCING ITS OPERATION THROUGH USE OF COMPUTER AUDIT

TECHNIQUES AND HAS BEGUN TWO PROBES TO VERIFY OVERTIME CLAIMS. WE EXPECT TO INITIATE SEVERAL COORDINATED AUDITS IN FY 1981 OVERLAPPING BUREAU LINES. AREAS CURRENTLY BEING CONSIDERED FOR SELECTION INCLUDE CERTAIN ASPECTS OF PAYROLL AND USE OF AUTOMOBILES. IN ADDITION, WE PLAN TO INITIATE A NEW APPROACH TO OUR APPRAISALS OF BUREAU AUDIT SYSTEMS BY REVIEWING CERTAIN ASPECTS OF THEIR AUDITING PROGRAMS ON A DEPARTMENTWIDE BASIS.

WE BELIEVE THAT OUR OPERATION HAS BEEN EFFECTIVE, AND THAT IT COMBINES THE BEST OF BOTH THE CENTRALIZED AND DECENTRALIZED APPROACH. BECAUSE TREASURY FOLLOWS A DECENTRALIZED MANAGEMENT CONCEPT, AND BECAUSE THE DEPARTMENT HAS FOUR ENFORCEMENT BUREAUS WHICH HAVE LONG HAD STRONG INSPECTION SERVICES, THERE WAS CREATED IN TREASURY AN OFFICE OF THE INSPECTOR GENERAL WHICH WOULD CONDUCT INVESTIGATIONS IN THOSE OFFICES AND BUREAUS WHICH HAD NO INSPECTION SERVICE, WHICH WOULD EXERCISE OVERSIGHT AND POLICY GUIDANCE WITH RESPECT TO THOSE BUREAUS WHICH HAD INSPECTION SERVICES. IT WAS FELT THIS WOULD NOT DUPLICATE OR DISRUPT OPERATIONS WHICH ALREADY EXISTED AND WERE FUNCTIONING EFFECTIVELY.

IN OUR OPINION, THIS APPROACH HAS WORKED SUCCESSFULLY. THE INSPECTOR GENERAL HAS THE AUTHORITY TO INVESTIGATE ANY EMPLOYEE IN TREASURY AND THE AUTHORITY TO CALL UPON BUREAU INSPECTION SERVICES TO PROVIDE WHATEVER INVESTIGATIVE OR OTHER SUPPORT PERSONNEL ARE NECESSARY TO CONDUCT INVESTIGATIONS, MAKING THE TOTAL PROFESSIONAL INTERNAL SECURITY STAFF THUS AVAILABLE APPROXIMATELY 515 PEOPLE.

AFTER THE INTERNAL INSPECTION FUNCTION WAS OPERATING EFFECTIVELY, A STUDY WAS CONDUCTED TO DETERMINE WHETHER A SIMILAR APPROACH SHOULD BE TAKEN IN THE INTERNAL AUDIT FUNCTION. ONCE AGAIN, WHILE THE DEPARTMENT DID NOT WISH TO DISRUPT THE BUREAU AUDIT OPERATIONS, IT DID RECOGNIZE A NEED TO PLACE POLICY GUIDANCE AND OVERSIGHT RESPONSIBILITY FOR THE INTERNAL AUDIT

FUNCTION IN THE OFFICE OF THE INSPECTOR GENERAL. AS A RESULT, ON FEBRUARY 20, 1980, THE SECRETARY TRANSFERRED THE OFFICE OF AUDIT TO THE INSPECTOR GENERAL.

IN ADDITION, ON FEBRUARY 27, 1980, THE SECRETARY DELEGATED TO THE DEPUTY SECRETARY THE APPOINTING AND EVALUATING AUTHORITY FOR ALL PERSONS RESPONSIBLE FOR THE INTEGRITY AND AUDIT FUNCTIONS IN THEIR BUREAUS, AND MANDATED A DIRECT REPORTING AUTHORITY BY THOSE PERSONS TO THE INSPECTOR GENERAL. WE ARE PRESENTLY IMPLEMENTING THIS NEW AUTHORITY. FURTHER, THIS CHANGE HAS ADDED APPROXIMATELY 750 PROFESSIONAL AUDITORS TO THE RESOURCES OF THE INSPECTOR GENERAL, MAKING THE TOTAL PROFESSIONAL STAFF AVAILABLE APPROXIMATELY 1,265. THUS, WHILE THE AUDIT AND INSPECTION OPERATIONS CURRENTLY REMAIN IN THE BUREAUS, THE ROLE OF THE INSPECTOR GENERAL IN THE PLANNING, EVALUATION, MONITORING AND CONTROL OF TREASURY BUREAU AND OFFICE INTEGRITY AND AUDIT PROGRAMS HAS BEEN CONSIDERABLY STRENGTHENED.

THIS CONCEPT RECOGNIZES THE NEED FOR SOME CENTRALIZED CONTROL OVER THESE FUNCTIONS, AND ALSO RECOGNIZES THE NEED TO MAINTAIN CONSISTENCY WITH THE DEPARTMENT'S DECENTRALIZED MANAGEMENT APPROACH.

ASSISTANT SECRETARY MCDONALD CAN ADDRESS FOR YOU THE BUDGETARY AND MANAGEMENT CONSIDERATIONS WHICH WERE INVOLVED IN OUR DECISION NOT TO TOTALLY CENTRALIZE THE AUDIT AND INSPECTION FUNCTIONS. IT IS A PLEASURE TO INTRODUCE ASSISTANT SECRETARY WALTER J. MCDONALD.

Mr. WIGRIZER. Thank you, Mr. Chairman.

With your permission, I would like to offer our statement for the record.

Senator CHILES. It will be accepted.

Mr. WIGRIZER. Basically, I think that we have been an effective organization. We do borrow people. We have at our disposal approximately 1,265 auditors and investigators. We have made a lot of progress. I have no roadblocks either at the Internal Revenue Service or any other agency. Our relations with Commissioner Kurtz and the other Commissioners have been most cordial. It has been very independent. I report directly to the Secretary and Deputy Secretary and we have been able to get a lot of work done.

What we have done is try to put an organization in place very quickly. I think we are ahead of a lot of organizations; we have done a lot of work.

One thing that I think I might mention with respect to the Internal Revenue Service, I haven't researched the whole issue of the 6103 disclosure—I think it is section (h)(1)—which allows the Secretary to have complete disclosure and anyone who works for the Secretary in tax administration is covered by the act, sir, the original Disclosure Act.

Senator CHILES. So you would be——

Mr. WIGRIZER. It would not be a roadblock.

Senator CHILES. Would not be a roadblock?

Mr. WIGRIZER. Not in my opinion, sir.

Senator CHILES. We have heard from GAO this morning arguing for the greater centralization—well, we will go on and take the rest of your statement.

PREPARED STATEMENT

Mr. MCDONALD. I have a statement and would also like to have that submitted for the record.

[The statement follows:]

Statement of W. J. McDonald

Needless to say, there were a number of management considerations which led us to the conclusion not to totally centralize the audit and inspection activities. I should preface my remarks by saying that we clearly recognized that there was an immediate need--

-- To improve the Department's oversight and control over the bureaus' inspection and audit activities; and

-- To integrate the Departmental audit function with the Inspector General activities.

The issue clearly was how to best achieve these objectives--whether through centralization or some other means.

With respect to integrating audit and the Inspector General's functions at the Departmental level, this was the easier of the two objectives. As Mr. Wigrizer has stated, this was accomplished in February by transferring the function from the Assistant Secretary (Administration) to the Inspector General. Although this was relatively easy to accomplish, its importance should not be overlooked. It provided the Inspector General with professional expertise that is essential in almost any investigation that he might pursue into waste, fraud, or error. Likewise, it eliminated the inevitable staff coordinating problems that had begun to develop under separation of the functions.

THE ISSUE OF CENTRALIZING ALL BUREAU AUDIT AND INSPECTION ACTIVITIES UNDER THE INSPECTOR GENERAL IS A MUCH TOUGHER ISSUE TO DEAL WITH. THE GAO REPRESENTATIVE HAS ALREADY PRESENTED THE FACTORS IN FAVOR OF CENTRALIZATION, AND I HAVE NO BASIC DISAGREEMENT WITH THESE ARGUMENTS. HOWEVER, THERE WERE OTHER CONSIDERATIONS WHICH LED US, AT LEAST FOR THE INTERIM, TO SOMETHING LESS THAN TOTAL CENTRALIZATION. LET ME BRIEFLY DISCUSS THESE.

MANAGEMENT PHILOSOPHY - AS MR. WIGRIZER HAS STATED, THE TREASURY HAS HISTORICALLY FUNCTIONED UNDER A DECENTRALIZED MANAGEMENT CONCEPT. EACH OF OUR BUREAU HEADS IS DELEGATED VIRTUALLY FULL AUTHORITY AND RESPONSIBILITY TO OPERATE HIS OR HER BUREAU. IN KEEPING WITH THIS PHILOSOPHY, OFFICE OF THE SECRETARY STAFFING HAS BEEN MAINTAINED AT A LEVEL TO PROVIDE ONLY BROAD OVERSIGHT AND POLICY DIRECTION TO THE BUREAUS. CONCURRENT WITH THE AUTHORITY AND RESPONSIBILITY ASSIGNED TO EACH BUREAU HEAD, THEY HAVE BEEN ENCOURAGED AND DIRECTED TO ESTABLISH THEIR OWN INTERNAL AUDIT AND INSPECTION STAFFS. THESE HAVE DEVELOPED OVER A PERIOD OF YEARS AND HAVE BEEN TAILORED TO FIT THE NEEDS OF A PARTICULAR BUREAU.

WE FELT THAT CENTRALIZATION OF THESE FUNCTIONS WOULD NOT ONLY DISTURB A HISTORICAL WAY OF OPERATING, BUT WOULD ALSO CAUSE BUREAU HEADS TO RELY ON AN OUTSIDE ENTITY TO PROVIDE OVERSIGHT OVER ACTIVITIES FOR WHICH THEY HAVE THE BASIC RESPONSIBILITY.

Carried to its extreme, centralization would deny bureau heads a valuable control mechanism which they have come to rely upon in the management of their bureaus.

Budgetary Considerations - A second major consideration was the budgetary implications of centralization. Centralization would result in almost doubling the size and appropriation of the Office of the Secretary. Traditionally, the Congress has not been in favor of such actions.

While one could argue that the overall budget of the Treasury would not be increased, since any increases to the Office of the Secretary would be offset by corresponding decreases to bureau appropriations, we question whether this would in fact be true. An organization of the type proposed would certainly require a management superstructure not presently available in the bureaus. We believe that providing central logistic and support services, such as personnel and financial management, will result in added costs.

In any event, centralization of these activities should not be considered without a detailed analysis of the possible budget implications. Since we were anxious to proceed as rapidly as possible, and the resolution of budgetary problems would have required OMB and Congressional approval, we sought another alternative.

MANAGEMENT CAPABILITY - THE SUCCESS OF CENTRALIZATION DEPENDS ON A MANAGEMENT STAFF WITH SUFFICIENT NUMBERS AND EXPERTISE TO MANAGE A DIVERSIFIED, NATIONWIDE AUDIT AND INSPECTION ACTIVITY. UNFORTUNATELY, WE DO NOT HAVE SUCH A STAFF AND GIVEN THE COMPLEXITIES INVOLVED, WE FEEL THAT IT WOULD TAKE A REASONABLE PERIOD OF TIME TO ASSEMBLE SUCH A STAFF. CONSEQUENTLY, IT WAS OUR OPINION THAT GIVEN THE CIRCUMSTANCES, IT WOULD TAKE AN INORDINATELY LONG PERIOD OF TIME BEFORE WE COULD DEVELOP THE MANAGEMENT CAPABILITY TO HANDLE A CENTRALIZED FUNCTION.

THEREFORE, WE REJECTED CENTRALIZATION FOR THE SHORT RUN AND DEVELOPED A STRATEGY TO GAIN GREATER CONTROL AND OVERSIGHT OVER BUREAU INSPECTION/AUDIT ACTIVITIES. MR. WIGRIZER HAS DESCRIBED THIS STRATEGY, WHICH WE FEEL HAS THE BENEFIT OF PROVIDING GREATER CONTROL AND DOES NOT REQUIRE ANY SIGNIFICANT INCREASE IN COST. IT ALSO PROVIDES FOR BUREAU HEADS TO HAVE SOME INPUT INTO THE OVERALL PROCESS. IN ADDITION, IT IS WITHIN OUR MANAGEMENT CAPABILITY TO IMMEDIATELY IMPLEMENT AND PROVIDES A BASIC FRAMEWORK FOR CENTRALIZATION SHOULD THAT BE CONSIDERED DESIRABLE AT A LATER DATE.

TO SUMMARIZE, LET ME SAY THAT WE ARE NOT OPPOSED TO CENTRALIZING INSPECTION AND AUDIT FUNCTIONS. HOWEVER, IN LIGHT OF OUR ACCOMPLISHMENTS TO DATE, AND THE PROBLEMS WHICH I HAVE OUTLINED, WE FEEL THAT WE SHOULD BE GIVEN AN OPPORTUNITY TO FULLY IMPLEMENT THE PROVISIONS OF THE MOST RECENT TREASURY ORDER. WE WILL, OF COURSE, CONTINUE TO CONSTANTLY EVALUATE OUR OPERATIONS.

Mr. McDONALD. Let me just very briefly summarize the thrust of my statement as an indication why we have adopted the type of organization we have gone to. I think one point that needs to be made in response to the GAO report concerning the matter of serving two masters. The present organizational structure we have is a very new one. It was implemented in February of this year and really has not had sufficient time to be placed in effect.

There are several considerations, I think, which one must look at when one talks about a centralized organization in the Department of the Treasury. I think one must consider that basically Treasury is a decentralized organization. The Bureau heads, one master, have the basic responsibility and authority for the functions that they perform. It is almost like night following day, they have to have some control, some input into the internal audit activities of their bureaus.

I think that is a very important consideration.

I think another consideration is the budgetary matter. To implement a centralized organization, we are talking about roughly 1,300 or 1,400 people who will be added to the roles of the Office of the Secretary along with the costs that go with them. I know there is a counterargument that overall this would not change the budgetary picture of the Treasury because you could transfer the people from the bureaus in which they reside along with the funds.

I think there is another factor that has to be considered if one does that. There would have to be some structure that presently does not exist in order to control an organization of some 1,400 people spread throughout the country. One must also take into consideration the added costs in terms of logistical support such as accounting services, and personnel services, so that it is our opinion that without a doubt, there would be some additional costs if we went to a centralized organization.

One final point, and that will conclude my statement and that is the whole question of Treasury having a management structure in place to suddenly or quickly manage an organization of some 1,400 people. It has been our conclusion that at the present time we simply do not have the structure to do that.

We have taken the view that we are not opposed to centralization, per se. We feel it is something that has to be done gradually. We feel the interim steps we have taken provide the basic groundwork, and will improve the audit and inspection function; likewise, it will give the Secretary greater control and should centralization be the ultimate goal, we will be in a position to do that.

Thank you.

Senator CHILES. That is all the statements?

Mr. McDONALD. Yes, sir.

ROLE OF TREASURY IG

Senator CHILES. Thank you very much.

Mr. Wigrizer, since you have been in the office about 1½ years now, how do you see your role as leading a Departmentwide effort against fraud, abuse, waste, and mismanagement, and do you have sufficient staff and authority to lead such a task?

Mr. Wigrizer. What we try to do is utilize the four inspection services that were in place, and we tried to take the same kind of—let me say "sensitivity," in the waste-fraud area that we found in the four ongoing bureaus and put it into the bureaus that don't have inspection services and never had inspection services.

In my view, we made good progress. There is a lot more to be done. The situation of borrowing people from the other bureaus has worked out very well. We have not had any conflict. I'll give you an example, what we would do is borrow a revenue inspector to do a job in a bureau that has no connection with revenue, so there couldn't be a conflict. Where we have had instances where we had to investigate revenue, we used people from my own staff.

We have had tremendous cooperation from the bureau heads. I think when we have the additional staff we have asked for in this budget, we can make progress. As Assistant Secretary McDonald says, this was something we could do immediately. We wouldn't have to get any OMB or congressional approval. We put this organization in place——

COST OF IG PROGRAM VERSUS BENEFITS

Senator Chiles. I just want to point out to you the Office of Inspector General we created across other agencies of the Government is not without some costs. We are incurring costs for their offices, we are incurring costs for their auditors, we are incurring costs for the investigators we have added. The Congress has figured as a matter of public policy that it is worth something to incur that cost to try to insure that there is going to be an integrity into the workings that are going to be carried out.

I understand you have had splendid cooperation. I think that is great. If I was one of these other agencies, in dealing with you, I would be cooperating too, rather than have you be staffed. What we are trying to do in creating the Inspector General, we are putting an irritant into each one of the agencies. We are transplanting against nature, we are trying to graft an irritant in that report to the President and to the Congress, appointed by the President, confirmed by the Senate, and he has to report back to the Congress so that he is not under any agency head, as such, he does not owe allegiance, nor do any of his people, to department heads.

And yet Treasury, which handles all the money of this country, and now has agencies like Customs, Alcohol, Tobacco and Firearms people and the IRS, suddenly says, "We don't need that, we should be exempt from that kind of arrangement. There shouldn't be that kind of independent agency looking at us." I don't see the argument for that right now. The fact that it is going to cost a few dollars does not sway me a bit. It is costing us something because of what happened in Customs in New York and elsewhere. It is costing us not only in dollars, it is costing us tremendously in public confidence. And how long was that going on before anyone got around to looking at it, how long had those rumors been out there, how long had that talk been out there?

Mr. Wigrizer. As you know, sir, Customs, with our cooperation, did uncover that.

LAGTIME OF CUSTOMS/ATF INVESTIGATIONS

Senator CHILES. Yes, finally, but that was on the street for a long, long time before they started to look at it.

The same thing has been on the street with ATF, and now something is about to be done on that.

I am glad to see Customs finally do it. I am glad to see ATF do it. I think had we had an Inspector General function properly, maybe we wouldn't have had either one of those to start with, not of the magnitude. That is why we are talking about why we need an Inspector General. We are going to look very carefully at this.

We recognize there are very special problems with IRS and we have to look at those problems. When we are setting up a structure here, as we are in the Office of the Inspector General, we are not looking at this year and how everybody is getting along. Hopefully we are looking at something we are building 10 years from now when the next real problem comes along, whether it be in Customs or anywhere else, or a potential IRS scandal that could really cause the taxpayers to lose faith and lose confidence.

Senator SCHMITT. Mr. Chairman, if you would yield.

Senator CHILES. I yield.

PROBLEM AVOIDANCE

Senator SCHMITT. Again, we are happy to say these problems have been uncovered, but the theory, anyway, of having an independent Inspector General is the problems would never arise, at least there is less a chance of them arising because of an independent look at the activities of the individual bureaus.

Mr. WIGRIZER. Since we have taken over in September of 1978, we did work with Customs in uncovering these. My office particularly spearheaded the drive in the Alcohol, Tobacco and Firearms, and I do agree with you in principle on the theory of the Inspector General.

Senator SCHMITT. We are trying to get prevention as well as finding out what is going on. Hopefully without the right prevention there will never be any problems. That might be a little unrealistic.

Senator CHILES. That is again why we want the audit side of that.

Senator SCHMITT. You haven't had time to become a preventive agency. We are not sure you can. In the present structure you can be a preventive irritant, if you will, in the Department.

Mr. WIGRIZER. We try to be, sir.

Senator SCHMITT. Thank you, Mr. Chairman.

BUDGET PROPOSALS FOR THE OFFICE OF THE SECRETARY

Senator CHILES. Now, switching, if we can, to the budget proposal of the Office of the Secretary, $33,995,000 and 836 permanent positions have been requested for fiscal year 1981, and $1,383,000 have been requested for the fiscal year 1980 supplemental.

Mr. McDonald, we will insert your full statement in the record.

[The statement follows:]

STATEMENT OF W. J. McDONALD

I appreciate the opportunity to come before you today to present the 1981 request for the Office of the Secretary "Salaries and Expenses" appropriation. The Office of the Secretary is requesting $34 million and 836 permanent positions for 1981, which is an increase of $2.2 million from the authorized level proposed for 1980. In addition, $1,383,000 is requested to cover the Office of the Secretary civilian pay act requirements for 1980.

The Office of the Secretary appropriation request includes positions and funds to support the Secretary and his staff of policy officials -- which includes staffs engaged in tax policy formulation, economic policy matters, state and local finance, internal inspection, and insurance policy formulation. In addition, the appropriation request also contains funding for the administrative support staff and the repair and maintenance of the Main Treasury and Annex Buildings.

The FY 81 Budget reflects an increase of 21 permanent positions and $1,269,000, plus $1,477,000 in resources to maintain the current level of operations. These requested increases, however, are offset by a reduction of $505,000. Thus, when compared with the level authorized for FY 1980, it represents a net increase of 21 permanent positions and $2,241,000.

Included in the program increases is a request for three additional positions for the Assistant Secretary (Tax Policy). These positions are requested to enable the Office of Tax Analysis to produce congressionally mandated reports on schedule and to develop new in-house capabilities for analyzing tax policies. When developed, these new capabilities would enable the office to answer the more sophisticated kinds of questions related to resolving fiscal and energy related problems via the tax system. Additional research funds are also requested to obtain data in support of the mandated studies and other on-going projects.

Three positions are requested to carry out the responsibilities of the Assistant Secretary (Domestic Finance) in the area of State and local finance and capital markets. Two positions are needed to monitor and assess State and local fiscal conditions and how they are affected by the national economy. One position is needed in the area of capital markets. These resources will be used to establish a better link to the securities industry, to analyze the Pension Benefit Guaranty Corporation and the housing and thrift industry in light of the current recession, and to provide a basic understanding of commodity futures markets as they relate to other futures markets and to international trade and trade financing.

I am requesting two additional positions for the Assistant Secretary (Economic Policy). In order to keep the Secretary and other top policy officials informed on current economic developments, additional resources are required to provide for more intensive research in financial and microeconomic aspects of the inflationary process to aid in forecasting the performance of the economy during a period of sustained inflation. Also, the increased number of energy bills enacted or under consideration by Congress necessitates more involvement in analyzing and evaluating energy supply, demand, and price developments and how they relate to the problems of inflation, lagging productivity, capital formulation, and government regulation.

Three positions are requested for the Inspector General. These resources will allow the office to adequately meet its responsibilities in implementing the President's Program on Waste, Fraud and Error, bureau oversight, systems studies, Office of the Secretary inspections, and inspection services for non-enforcement Treasury bureaus.

Ten positions are requested for the Insurance Analysis initiative. This function is being created to provide overall guidance on, and policy analysis of, insurance related problems to the Executive Office of the President, the Secretary and other agencies and departments. This function will enable the Federal government to develop a coherent and comprehensive approach to insurance problems.

Finally, I am requesting $600,000 for the replacement of the Treasury Annex elevators. Since 1974, when Treasury was given the responsibility for repairs and improvements to the Main Treasury and Treasury Annex, a very active program has been undertaken to bring these buildings up to certain safety and habitable standards.

Changes to the budget, other than the program increases already mentioned, include an increase of $1,477,000 to maintain the current level of operations. These funds provide for increasing communication costs, within grade salary increases, space costs, the annualization of increased positions granted in 1980, and similar costs for the ongoing current programs.

The budget increases are offset by a decrease of $505,000 for program reductions and increased productivity.

Pursuant to Executive Order 12165, this committee also has before it a supplemental request of $1,383,000 to cover the Office of the Secretary civilian pay act requirements.

The FY 1981 budget request reflects a $1.2 million decrease from our initial FY 1981 request. Also our request for funds to cover the civilian pay act requirements for 1980 has been reduced by $108,000.

The reductions which were made to the initial FY 1981 budget request reflects decreases in two program areas. Our initial budget request for the Office of the Assistant Secretary (Tax Policy) was reduced by $180,000. This amount was designated for contractual services outside of the federal government. In addition, we have reduced our Repairs and Improvement FY 1981 budget request by $1,020,000. This reduction represented funds which were earmarked for major systems renovations in the Main Treasury Building.

This concludes my prepared statement, Mr. Chairman. I shall be happy to answer any questions you or other members of your Committee may have.

INSURANCE ANALYSIS PROGRAM

Senator CHILES. I wanted to ask you, currently the work proposed for the new insurance analysis program is being done by a task force of the Department of Commerce. What are the resources by number of positions in dollars devoted to this activity at the Department of Commerce, and what specific problems is this office intended to address?

Mr. McDONALD. I have no idea what resources Commerce devotes to this. I would make one point: I am not sure the function we are talking about with respect to the insurance analysis is the identical function that the Department of Commerce is performing.

Basically, I think we are talking about a new function being delegated to the Treasury which would involve Government-wide coordination and review of insurance-related policies. We are talking about an organization that would be responsible for collecting and maintaining financial and economic data relating to insurance programs.

Senator CHILES. Is there some reason that cannot be handled by the task force at the Department of Commerce?

Mr. McDONALD. I think the idea behind this is to get an independent agency that does not have a particular vested interest in an insurance-related problem so we would have this as a Government-wide function.

TWO PERCENT CUT IN OVERHEAD

Senator SCHMITT. Mr. McDonald, what would be the effect of a 2-percent cut in administrative overhead?

Mr. McDONALD. Two percent?

Senator SCHMITT. Just to pick a number out of the air, over the budget that has been submitted? Could you absorb that in administrative efficiencies.

Mr. McDONALD. My guess would be it would be about 10 to 15 positions, roughly. Could we absorb that, is that your question?

Senator SCHMITT. In terms of administrative efficiencies, attrition, if necessary, but other efficiencies within the Department.

Mr. McDONALD. Conceivably, yes.

Senator SCHMITT. How would you do that? Travel reductions, more efficient use of telephone service?

Mr. McDONALD. More efficient use, perhaps, or making greater use of computers, word processing equipment, things of that nature.

Senator SCHMITT. That you already have.

Mr. McDONALD. I beg your pardon?

Senator SCHMITT. That you already have?

Mr. McDONALD. Yes, sir.

ADMINISTRATIVE TRAVEL

Senator SCHMITT. Is there much administrative travel related to conferencing within the Department itself?

Mr. McDONALD. I don't have specific figures. I would have to assume that is a reasonable amount, yes.

Senator SCHMITT. Has the Department done any experimentation or begun to utilize teleconferencing as a substitute for travel?

Mr. McDONALD. Not to the best of my knowledge.

Senator SCHMITT. Do you have any experience with teleconferencing that you think it would be able to satisfy the needs within the Department in some areas where travel now is required?

Mr. McDONALD. I personally have no experience with it. I have no one with me, either who has this knowledge.

Senator SCHMITT. A number of agencies have been trying to use teleconferencing as a substitute for travel. It might be useful to talk with them.

Mr. McDONALD. We will certainly look into it.

Senator SCHMITT. I think NASA and the Department of Energy tend to use teleconferencing more technically-oriented agencies. You might look into it.

Mr. McDONALD. We will look into it.

Senator SCHMITT. We will have additional questions for the record.

Senator CHILES. We will not have time to hear Mr. Kallen's statement on the 1980 supplementals but his full statement will be inserted in the record at this point.

[The statement follows:]

STATEMENT OF ARTHUR D. KALLEN, DIRECTOR, OFFICE OF BUDGET AND PROGRAM ANALYSIS, DEPARTMENT OF THE TREASURY

Mr. Chairman and members of the Committee, I appreciate the opportunity to appear before you in support of the Department's request for supplemental appropriations for pay increases and certain program requirements during fiscal year 1980.

The supplemental funding requirements for fiscal year 1980 pay increases are included in the revised 1981 President's budget to the Congress and amount to over $132 million. We are proposing one transfer from the Bureau of the Mint construction account to the U.S. Secret Service to meet pay increase requirements in that Bureau. The proposed transfer has enabled us to reduce the amount that we are requesting to be appropriated by your Committee.

The pay requirements were not calculated when the fiscal year 1980 appropriations were considered and approved last year. All increases requested by the Department for pay increases have resulted from Executive Order 12165, effective October 1979, and wage board surveys issued pursuant to Public Law 91-656. Under that law, the salary rates of civilian salary systems are adjusted to achieve comparability with rates paid for similar work in private industry. The wage board actions are based on periodic surveys of the prevailing wages paid to workers in the private sector in the same area engaged in similiar endeavors. The supplemental requirements also include pay increase costs for the Uniformed Division of the Secret Service (authorized by D.C. Act 2-90). The attached table shows the total costs of the new pay rates by bureau. This table is in agreement with the amount shown in the President's revised 1981 budget document.

The supplemental requests before you reflect significant absorption levels in most of our bureaus. We have been able to identify savings in several programs which has helped reduce the amount of our supplemental request. For example, in response to Congressional direction, we have reduced travel costs by approximately 8 percent. Also, the bureaus have evaluated closely their programs in an effort to hold pay increase supplemental requests to a 5.5 percent increase, the amount previously identified by the Administration as the level for FY 1980, and additional savings related to the Government-wide hiring restrictions announced on March 14, 1980. The savings identified by the bureaus totals $39.5 million. To every extent possible, we have called on the bureaus to absorb these increases without materially sacrificing the quality of work performed. The supplemental requests before you reflect these absorption efforts.

In addition to absorption of a part of the fiscal year 1980 pay requirements, the bureaus are also being asked to fund within their appropriation various price increases occurring during the year, such as, printing and supplies, fuel, communications costs, health benefits costs, etc. For this reason, these pay supplemental requests are very important to the maintenance of existing bureaus' programs.

Also included in our supplemental request is $40.1 million in program supplementals for the Bureau of Government Financial Operations, Bureau of the Public Debt, Internal Revenue Service, and U.S. Secret Service. The attached chart gives a brief explanation for these requests. The Bureau heads will be able to address in detail these requests during their individual testimonies.

I appreciate the Committee's consideration of these requests.

DEPARTMENT OF THE TREASURY
FY 1980 Revised Supplemental Requests
(Dollars in Thousands)

Bureau	Pay	Program	Comments
Office of the Secretary	1,383 (-108)	—	
International Affairs	199 (-250)	—	
Federal Law Enforcement Training Center	399 (-)	—	
Bureau of Government Financial Operations:			
Salaries and Expenses	-322 * (-322)	—	
Payment to Guam, Virgin Is. and American Samoa	—	2,000 (-)	This proposed supplemental appropriation would provide funds to reimburse the Government of Virgin Islands for losses incurred under the Tax Reduction and Simplication Act of 1977.
Bureau of Alcohol, Tobacco and Firearms	5,219 (-)	—	
U.S. Customs Service	22,153 (-)	—	
Bureau of the Mint	310 (-321)	—	
eau of the Public Debt	2,616 (—)	23,558 (+16,400)	Provide for increase workload occurring in savings bond redemptions, Treasury bill book-entry accounts, and other Bureau operations.
Internal Revenue Service:			
Salaries and Expenses	7,072	—	
Taxpayer Service & Returns Processing	27,536	—	
Examinations and Appeals	38,316	—	
Investigations and Collection	26,260	—	
Total, IRS Operating Accounts	99,186 (-6,966)	—	
Payment where Energy Credit Exceeds Tax Liability	—	1,000 (-)	Provides for additional payments to businesses when the solar wind credit due them exceeds the amount of tax liability owed.
U.S. Secret Service			
New Appropriation	1,370 (-)	13,550 (-)	Provides for the increase cost of protective travel, Presidential candidate and nominee protection (10,800) and reimbursements to State and local governments for protection of foreign diplomatic missions under extraordinary circumstances (2,750).
From Mint Construction	5,730	—	
	7,100 (-)	13,550 (-)	
Total Treasury	138,243	40,108	
From Existing Appropriation	-5,730	—	
	132,513 (7,967)	40,108 (+16,400)	

NOTE: Parenthesis items refer to Presidential reductions for Government-wide hiring freeze.

* Rescission proposal

ADDITIONAL QUESTIONS

Senator CHILES. We will have additional questions for the record, too.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR CHILES

AUTHORITY OF TREASURY INSPECTOR GENERAL

Q. Mr. McDonald, we have heard GAO this morning argue for greater centralization of audit activities at Treasury and for Treasury's IG office to be given more resources and authorities similar to the statutory IG offices. Do you believe that Treasury's efforts against fraud and mismanagement should be strengthened by providing Treasury's IG office with some of the same authorities of the statutory IGs?

A. Under the authority delegated by the Secretary on February 27, 1980, Treasury's Inspector General has substantially the same authority as the statutory Inspectors General, with the exception of administrative summons authority. While this authority would be useful, the Inspector General's experience to date has been that the lack of summons authority has not been a bar to obtaining any records needed for any of his investigations. Further, under our concept the Inspector General reports directly and exclusively to the Secretary and Deputy Secretary.

Q. Do you foresee any particular problems if Treasury were covered by the Inspector General Act?

A. Yes, it would require significant additional funding. Also, it would require the creation of a competent management structure in order to manage the diverse field organization required. If adequate funds were not received and if a management staff were not in place, it would be extremely difficult for Treasury to implement the type of organization envisioned under the Inspector General Act.

Q. Mr. Wigrizer, since you have been in office for 1 1/2 years, how do you see your role as to leading a Department-wide effort against fraud, abuse, waste and mismanagement?

A. My role is one of strong oversight and coordination. Consistent with Treasury's decentralized concept, we work with the bureaus to develop audit and investigative plans, periodically review their operations and make recommendations for change where appropriate. Additionally, this office conducts or directs investigations in any case where I deem it appropriate, particularly those involving high level officials.

Q. Do you have sufficient staff and authorities to lead such an effort?

A. Treasury has significant audit and inspection resources (about 750 professional auditors and 515 inspectors) which can be made available to me as Inspector General. Although most of the auditors and inspectors are located at the bureau level, we have utilized them for our investigations in line with our authority from the Secretary. In the future, we plan to emphasize the use of staff from various bureaus to assist on joint projects and to augment my immediate staff as necessary. With the authority recently given me by Secretary Miller, I am confident that this approach will permit me to obtain those resources necessary to successfully lead the effort against fraud, abuse, waste, and mismanagement.

AUDIT AND INSPECTION PLANS

Q. Your recent increase in authority specifies that you have approval authority over internal audit and investigative plans of the Treasury bureaus. How are you going to implement this in view of the present size of your staff?

A. We believe that a well thought out audit plan for each Treasury bureau is the basis upon which the bureaus can establish an effective audit effort. The monitoring of the bureau's accomplishments is an important area for assessing the audit system's effectiveness. Therefore, we plan to emphasize our oversight role of the bureau internal audit staffs.

I am confident that the Office of Audit will be able to review, recommend, and approve audit plans in a timely manner with the personnel presently available. If, however, we find that we are unable to meet the required time frames, I would not hesitate to request assistance from bureau audit staffs.

In addition to using the staff resources of the Office of Audit to review bureau audit plans, we plan to initiate a joint project covering the methodology of the planning process in all bureaus. With this project, we expect to utilize the best aspects of the planning methods in all bureaus to provide guidelines for future planning and expand on the criteria in OMB Circular A-73 assessing planning efforts.

With respect to the inspection function, we intend to work with the senior bureau officials in those bureaus that do not have adequate proactive programs to study their operations and develop plans, tailored to each bureau, to assess the vulnerability of those bureaus to fraud and abuse. The plan will be carried out by bureau personnel, and we will maintain a review and oversight role. Inspectors and analysts will be detailed as needed to assist the bureaus in developing these programs.

Q. Do you have any criteria in mind to evaluate the plans?

A. OMB Circular A-73 on audits of Federal operations contains the basic guidelines that will be used in evaluating audit plans. For example, it requires determination of the universe subject to audit and that such things as the newness, changed conditions, size, sensitivity, and vulnerability of activities subject to audit be considered in determining the audit coverage, frequency, and priorities. These considerations should be elaborated on in audit plans. One of the primary things that we will be looking for in the annual plans are detailed explanations justifying certain audits or delaying other work. Each inspection plan will be tailored to the particular bureau, and will focus on those areas most vulnerable to fraud and waste.

Q. What kind of mix of audits do you see as desirable - economy and efficiency, financial and compliance, effectiveness, vulnerability analyses?

A. In our view, it is difficult to separate audits into separate categories; audits are often a mixture of financial/compliance, vulnerability analyses, and economy/effectiveness. Because a large portion of bureau operations is financial in character, the emphasis has been placed on financial and compliance audits. It should be recognized that an integral part of a financial audit is to review and test the system's internal controls and consider the system's vulnerability.

In the future, we envision as part of our oversight responsibility, placing more emphasis on proactive audits to stress the prevention of fraud, waste, abuse and mismanagement. This does not mean that we will abandon financial audits. We intend to schedule cyclical financial audits, and conduct economy and efficiency audits, and effectiveness reviews. The actual mix of the audits will vary from bureau to bureau because of the diverse nature of their operations. We expect each bureau to justify its mix of audits in the audit plan. We will review the plans and recommend those changes we believe are appropriate.

Q. Do you intend to assure that there is a cyclical pattern to financial audits?

A. Yes, we believe it is important to have cyclical financial audits and we would like to have financial audits conducted at least every three years. It should be recognized, however, that actual compliance with this objective will be affected by certain other factors. In developing audit plans, staffs will be required to prioritize each audit relative to the entire audit universe on the basis of various factors including vulnerability. In some cases the cycle may be less than three years. In other situations, there may be other audits which are considered to have a higher priority than the financial audit. This would cause a delay in the cyclical financial audit. However, subsequent audit plans would compensate for any delay beyond the normal cycle by increasing the delayed audit's priority in subsequent periods.

Q. GAO pointed out that you did not prepare an investigative plan for your office for fiscal year 1980. How do you expect to require and approve bureau plans when you have not even prepared one for yourself?

A. Because of the sensitive and high priority nature of many of the allegations received by this office during our 18 months of operation, and because it has been necessary to establish the office, and in view of our available resources, most of our work to date has been reactive in nature, with outstanding results.

With the additional authority and resources given to the office under the Secretary's delegation order, we are now in a position to devote more time and resources to proactive investigations, to develop further plans for this office, and to go ahead with the review of bureau inspection plans.

REPORTING RESPONSIBILITIES

Q. Do you foresee any problems with the arrangement of having bureaus report to both you and the bureau head?

A. No. There have been none to date, and we do not anticipate any. This arrangement is meant to insure that, while the priorities of bureau heads to manage their bureaus are considered by the heads of the audit/inspection staffs, so too are the priorities set by the Inspector General, to operate the bureaus free of fraud, abuse, waste and mismanagement, considered. Since the Inspector General and all bureau heads report to the Secretary and his Deputy, to the extent that there might be conflicting priorities, these conflicts can be taken to and resolved by the Secretary or Deputy.

Q. Will these people not be prone to listen to the person that pays them -- the Bureau -- and not the Inspector General? For example, under decentralized internal auditing, can you reasonably expect the internal auditors to question policies made by bureau heads when they must depend on the bureau heads for their livelihood?

A. We do not envision significant problems of this nature, since all of us report to the Secretary and the Deputy Secretary and the Deputy is the appointing and evaluating official for the heads of the audit/inspection functions. I have confidence in the integrity of the Department audit and inspection staffs and have the full support of Treasury's highest officials in fulfilling my mission

Q. You have program oversight responsibility -- seeing that the bureaus toe-the-line -- and you also need their help in conducting investigations. I understand that you received the equivalent of 15 years of staff help in 1979 by detailing in people from the agencies. Can you on the one hand criticize the agency programs and on the other go to them and ask for staffing help?

A. Our experience to date has indicated that this is no problem. Actual cases have proven to us that this procedure works and illustrates the independence of the audit and inspection staffs in Treasury. Should we ever encounter any problems, the matter would be brought to and resolved by the Secretary or Deputy Secretary.

AUDIT PLANNING

Q. GAO has pointed out some drastic differences in the results of the internal auditing and investigative programs in Treasury. In 1979, for example, savings from audit recommendtions of 5 of the bureau programs were zero while the IRS audit group recommended action that would save $302,000,000. Are we to believe that the bureaus where internal auditors found no savings that there are no savings to be found? Are the programs so good that there is no room for improvement? Why have the auditors not identified and recommended improvements? What are you doing to tighten up these programs?

A. We believe it is important to distinguish between Treasury and other Federal agencies concerning dollar savings in audits. Treasury does not have the spending programs which are characteristic of other agencies and which are so susceptible to fraud and abuse. Treasury is primarily a law enforcement and revenue collection agency.

We agree that there is probably room for improvement in the direction of audit effort, which may result in dollar savings at bureaus which recently have not reported any such savings. However, it is important to consider the types of bureau operations and the vulnerability of their operations, compared to the potential dollar savings from more efficient operations, when deciding where to expend audit effort.

The bureau audit staffs, in many cases, spend significant amounts of audit effort on internal control reviews. For example, at Public Debt, significant amounts of audit effort must be spent on reviewing controls over principal and interest transactions. The Bureau of the Mint must be concerned about the custody of bullion and control of coins. The Bureau of Government Financial Operations also reviews custody of gold and needs to spend large amounts of its time reviewing internal controls over such operations as electronic fund transfers, check manufacturing, controls of check stock, destruction of unfit currency, and other central accounting and disbursing operations.

The potential for loss or damage to the Government in these types of operations warrant, we believe, significant amounts of audit effort. In our reviews of audit plans, we expect to find an appropriate mix of the types of audits to be conducted. We do not believe, however, that economy and efficiency reviews should be done at the expense of assuring that adequate controls are maintained over some of the most significant transactions and assets of the United States.

Q. According to OMB Circular A-73, each agency is required to prepare an audit plan. This plan is supposed to indicate the audit universe, audit priorities within the universe, and a justification for those priorities as well as audit cycle, scope and benefits. GAO has found serious problems with the audit plans of almost all the Treasury bureaus. What have you done in this area to improve the agency audit plans and what do you plan to do?

A. With the issuance of Treasury Order 101-15, dated February 27, 1980, authority was specifically given to the Inspector General to review and approve bureau and office audit plans. We believe that requiring this additional review is a significant action designed to strengthen the bureau's audit planning process. In implementing this authority, we will be utilizing OMB Circular A-73 requirements as criteria for evaluating bureau plans. As stated previously, we also expect to initiate a joint project to review bureau audit planning methodology and to make recommendations for improvements.

INVESTIGATIVE PLANNING

Q. Similarly, what have you done and what do you plan to do about investigative planning? Do you see a need for Departmental planning of proactive investigations?

A. With respect to the planning of proactive investigations, we intend to review the proactive programs of those bureaus that have inspection functions, and intend to develop such programs in those bureaus that do not. We will work with senior bureau officials to study their operations and develop proactive plans tailored to each bureau, but drawing on the experience of other bureaus, to assess the vulnerability to fraud and abuse. While the programs will be carried out by bureau officials, we will review and maintain oversight over these operations. Further, in my role as coordinator for the Department's effort against fraud, abuse, waste and mismanagement, and with the authority I have over all audit/inspection functions, I will be able to conduct and direct coordinated audits where appropriate, and insure that strong internal controls which have been effective in one bureau can be utilized in other bureaus.

The remainder of our investigative planning must be reactive. The reactive investigations will be viewed against the available resources and realistic priorities. We will, of course, continue to exercise strong oversight over the bureau operations to insure the proper conduct of investigations and to insure that their priorities are appropriately set.

Q. Under your authority, can you hold the bureaus internal and investigative programs accountable for (1) fulfilling the goals established in their work plans, and (2) carrying out specific proactive projects?

A. Yes. In addition to approving plans, Treasury Order 101-15, dated February 27, 1980, gave the Inspector General the authority to evaluate bureau audit and inspection programs. This includes determining whether goals established in the audit plans have been accomplished. Auditors and investigators in the bureaus will be expected to accomplish a reasonable portion of their plans, particularly as the plans relate to matters that have been identified as having a high priority. The Inspector General is also authorized to require and review reports. In evaluating programs, reasons for not meeting goals will be considered and commented on. In addition, the evaluation will include reviews of reports issued and whether the program included an appropriate mix of work, including internal control reviews as proactive projects. Finally, any signigicant problems disclosed in audits and investigations, or the failure of a bureau to substantially fulfill goals or carry out proactive projects would be reported to the Secretary or the Deputy Secretary.

NEW INSURANCE ANALYSIS PROGRAM/+$325,000 AND 10 POSITIONS

Question: Currently the work proposed for the new Insurance Analysis Program is being done by a task force in the Department of Commerce. What are the resources (number of positions and dollars) devoted to this activity at the Department of Commerce?

Answer: Annually, the Department of Commerce devotes from one-half to three quarters of a staff year, and approximately $20,000, to the Interagency Council on Accident Compensation and Insurance.

Question: What specific problems is this office intended to address?

Answer: Insurance Analysis will provide overall guidance on and analysis of insurance related problems. Specifically, it will attempt to avoid piecemeal solutions to Federal liabilities.

Question: Why couldn't it continue to be handled by the task force at the Department of Commerce?

Answer: During the course of a product liability study, Commerce realized that it was examining only a small part of a growing problem and recommended that an interagency council on accident compensation and insurance be established. The Administration approved this proposal and it was announced in the Federal Register on September 11, 1978. As a result, the task force on product liability in Commerce was assigned the tangential responsibility of chairing the new council with no increase in resources, hence the nominal amount of resources mentioned above.

From the first meeting of the interagency council, there emerged a clear consensus on the paucity of credible expertise, the inadequacy of existing coordination and the lack of consistent approaches to insurance problems. Despite this agreement, the lack of permanent and knowledgeable staff has severely limited the Council's ability to meet OMB and Domestic Policy Staff objectives. Moreover, while Council members are eager to obtain "technical assistance", they are not inclined to provide resources that might be used to analyze critically the policy implications and longterm cost of their own insurance related initiatives.

Because of the limitations of the existing council, both in resources and expertise, the Treasury is requesting positions and funds to initiate an insurance analysis function. This will not be a duplication of Commerce's efforts since the interagency council will expire on September 1, 1980. It should also be noted that Treasury will not have, and will not seek, regulatory responsibilities, but rather will provide overall guidance, and policy analysis of, insurance-related problems to the Federal government.

Question: Couldn't this program be funded by reallocations within the $32,000,000 base for the Office of the Secretary?

Answer: The Office of the Secretary resources contain no flexibility of positions or funds. Within the last nine budget years, the Office of the Secretary, Salaries and Expenses has received a net of only 42 positions and $263,000. Additional positions and funds are necessary to support this function.

REPAIRS TO THE TREASURY BUILDING

Question: I understand that the request of $1.6 million for repairs and improvements to the Treasury building has been withdrawn as a part of last month's budget cutting exercise. What will be the impact of deferring these repairs and improvements?

Answer: The funds withdrawn from the Fiscal Year 1981 request were to provide for continuation of work associated with 10 zones of heating, ventilation and air-conditioning systems and other related work. Based on contracting information now available, funds provided in previous Fiscal Years for this project are being utilized for a construction contract to be awarded in Fiscal Year 1981, which will continue into Fiscal Year 1983. When awarded, this contract will demonstrate the actual amount of work which can be achieved with the money on hand, and also provide a fairly accurate assessment of the total funds needed to complete this major project. Therefore, funds for the completion of this project will be included in our request for Fiscal Year 1983, and our long range plan has been amended to this effect. No adverse impact is envisioned since this construction and funding schedule, if adhered to, will allow an award for the remainder of the construction to be made in Fiscal Year 1983 following the work scheduled for completion in that Fiscal Year.

ECONOMIC POLICY

Question: Two more positions are requested in order to permit "more intensive analyses of the inflation problem" (P. OS-7). Isn't the Department and in fact the Administration already intensively analyzing the inflation problem?

Answer: The Administration and the Office of the Assistant Secretary for Economic Policy are engaged at all times in analyzing inflation. However, inflation analysis--among economists generally--has been concentrated on short term demand factors. The two additional positions would be used to deal with two important aspects of the long-term inflation problem which have received insufficient emphasis: (1) the interplay of productivity growth, energy price increases, and inflation, and (2) the impact of domestic and international monetary policies and developments on inflation. We hope ultimately to include a sophisticated understanding of these phenomena in long run forecasting models, used as a foundation for economic policymaking in the Administration.

DOMESTIC FINANCE

Question: Three additional positions are requested to analyze state and local finances. Why can't this activity be absorbed within the base?

Answer: The Assistant Secretary for Domestic Finance requested a total of three positions, however, only two positions are for the Office of State and Local Finance. The additional positions are necessary because the responsibilities of the Office of State and Local Finance are increasing rapidly. The Office now provides the Department of the Treasury with one of the Federal government's primary centers of expertise in the analysis of State and local fiscal conditions, financial operations, and Federal intergovernmental fiscal policy.

The current staff, which consists of seven professionals and two secretaries, is too small to stay abreast of all the matters on the agenda of the Office. The limited staff size and other resource constraints often require the Office to respond on an exception basis to very current issues. This prevents the Office from concentrating on preparation for expected future legislative requests and long-term research and policy issues.

In order to fullfil its responsibilities for monitoring State and local fiscal conditions, the Office must be familar with the entire range of Federal intergovernmental policies all major grant legislation, and it must accurately track the fiscal condition of major cities, the individual states, and their responses to developments in the national economy.

The positions in question are intended to support and increase Treasury's growing responsibilities in this area in several ways. First, they will greatly increase the capacity of the staff to respond to the increasingly frequent demands from within Treasury, the White House, the Congress, and OMB for short-term policy analyses, economic projections, and impact studies.

Second, they will increase the ability of the staff to carry out the longer-term studies necessary for the development of carefully thought-out policy options and legislative initiatives that the White House and OMB increasingly expect from Treasury in the area of intergovernmental fiscal relations.

Third, the efficiency of the staff, particularly the senior staff, will be greatly improved by the additional capacity to do the preliminary data compilation and analyses, and the computer work often necessary in the development of policy options.

Fourth, the Office of State and Local Finance is under increasing pressure to review and respond to analyses done by other agencies, and to cover Congressional hearings. These activities are time comsuming, but necessary. Additional staff is needed just to keep up with these activities.

FURNITURE

Question: For each of the Treasury Bureaus and agencies, how much was spent in fiscal year 1979 for furniture? How much is included in the fiscal year 1980 budget for furniture? How much is included in the fiscal year 1981 budget request for furniture?

Answer: The budgeted levels for furniture are $7.2 million, $7.3 million and $8.2 million for fiscal years 1979, 1980 and 1981 respectively. The amounts by bureau are as follows:

DEPARTMENT OF THE TREASURY
Budget Levels for Office Furniture
(Dollars in Thousands)

	Amounts		
	FY 1979	FY 1980	FY 1981
Office of the Secretary	$ 33	$ 32	$ 35
International Affairs	20	20	20
Office of Revenue Sharing	43	27	27
Federal Law Enforcement Training Center	45	13	15
Government Financial Operations	19	54	57
Alcohol, Tobacco and Firearms	705	244	73
U.S. Customs Service	736	700	700
Bureau of the Mint	24	20	20
Bureau of the Public Debt	54	106	106
U.S. Savings Bonds Division	39	30	25
Internal Revenue Service	5,330	5,896	6,904
U.S. Secret Service	227	200	200
TOTAL	$7,275	$7,342	$8,182

Question: Does the Department or do each of the bureaus have an inventory of excess furniture? If so, how much is included in the inventory?

Answer: Yes. On October 23, 1979, prior to the current Interagency Inspector General Joint Task Force on personal property, the Department implemented on its own initiative, an inventory of Treasury's office furniture nationwide in warehouses and other storage areas. This inventory was completed on December 17, 1979, and resulted in 14,802 pieces of furniture being shown as excess. The following is a list, by bureau, of excess furniture in their inventory as of December, 1979:

Office of the Secretary	303
Alcohol, Tobacco and Firearms	367
Comptroller of the Currency	0
U.S. Customs Service	805
Engraving and Printing	183
Federal Law Enforcement Training Center	0
Government Financial Operations	285
Internal Revenue Service	12,451
Mint	92
Public Debt	244
U.S. Savings Bonds Division	72
U.S. Secret Service	0

Since this inventory was completed, the GSA Furniture Management Reform Plan has been initiated. This plan has five major initiatives one of which has had an impact on the amount of excess furntiure in this inventory. Operation Clean Sweep (GSA initiative) began on March 31, nationwide except the National Capital Region (NCR) and will return all excess furniture held by agencies to GSA for reissue as needed. In the NCR, all agencies' stored furniture will be reported to and controlled by GSA, effective May 1. Due to the furniture freeze imposed by OMB, on Federal agencies in February 1980, a considerable amount of this excess furniture is no longer in the inventories, but reutilized by other Treasury bureaus for use or other Federal agencies.

Question: Does the Department ever use furniture out of the GSA warehouses or from the GSA excess real and personal property program? If not, why not?

Answer: Yes. Federal Property Management Regulations 101-43 provides guidelines for excessing and obtaining excess property from GSA and other Federal agencies. Treasury Directive TD 70-03 (a copy attached) provides details to Treasury bureaus for obtaining excess personal property, through GSA excess personal property program as implemented by the Department.

(The information follows:)

Department of the Treasury **Directives Manual**

Chapter TD 70	Section 03.A
Transmittal Number 141	Date: 9-20-78

SUBJECT:

PERSONAL PROPERTY MANAGEMENT PROCEDURES

1. PURPOSE.

a. This directive establishes Treasury policies and procedures pertaining to the general area of personal property management. It is published to assist the property management officers in the performance of their responsibilities under Subparts E and H of the Federal Property Management Regulations (FPMR) 41 CFR Chapter 101 and applicable statutes.

b. Instructions are included to set forth specifics governing the use, display and acquisition of the Treasury flag and the use and display of the Treasury seal other than for official printed matter, as well as the Department's antique property program.

2. SCOPE. This directive applies to the Office of the Secretary and all bureaus.

3. CANCELLATION. TD 70-03.A, Personal Property Management Procedures, dated 5/4/76.

4. REFERENCES.

a. 41 CFR Chapter 101. Various subparts of the Federal Property Management Regulations establish requirements for procurement, issue, use, and disposal of personal property.

b. Treasury Department's Principles, Standards and General Requirements for Administrative Accounting Manual. Section 2050 of the manual provides guidelines for accounting for personal property, including capitalization.

c. Treasury Personnel Management Manual Chapter 451, Incentive Awards Program, provides authorization for use of printed miniature official flags of the Department of the Treasury.

5. ACTION. Treasury Personal Property Management Officers are required to submit:

a. The Supply Activity Report, Interagency Report Control No. 1220-GSA-AN, in accordance with paragraph 6f of this directive. Due: November 15 of each year.

b. The Exchange and Sale Transaction Report, IRC No. 1528-GSA-AN, in accordance with paragraph 7h of this directive. Due: November 30 of each year.

c. The Annual Report of Utilization and Disposal of Excess and Surplus Personal Property, IRC No. 0015-GSA-AN, in accordance with paragraph 7k of this directive. Due: November 15 of each year.

d. Annual Requirements for the Treasury Flag in accordance with paragraph 8d, as may be applicable. Due: September 1 of each year.

e. The Annual Report of Excess Personal Property Furnished Non-Federal Agency Recipients, IRC No. 0154-GSA-AN, in accordance with paragraph 7.1 of this directive. Due: November 30 of each year. (First report due: FY 1978).

6. SUPPLY AND PROCUREMENT POLICIES AND PROCEDURES.

a. General. Policies and guidelines pertaining to the general area of supply management designed to support the logistical programs of the Federal Government appear in the Federal Property Management Regulations (FPMR), Parts 101-25 through 101-34. Guidelines for accounting for property, including capitalization, are contained in Section 2050 of the Treasury Department's Principles, Standards and General Requirements for Administrative Accounting. In addition, individual bureau accounting manuals should contain data on accounting for property. Treasury bureaus shall ensure that, except for emergencies, Government personal property and nonpersonal services are used only for those purposes for which they were obtained or contracted for or other officially designated purposes.

b. Acquisition of Office Furniture and Machines. As directed by FPMR 101-25.104, Treasury bureaus shall make a determination as to whether their requirements can be met through already-owned items prior to the acquisition of new furniture or office machines. The acquisition of new items shall be limited to those requirements which are considered absolutely essential and shall not include upgrading to improve appearance, office decor, status or to satisfy the desire for the latest design or more expensive lines.

c. Executive Type Office Furniture. FPMR 101-25.302-1 restricts the use of executive type wood office furniture to personnel in grade GS-15 and above, and, with approval of the head of the agency or his designee, to secretaries and staff assistants if the particular position and responsibilities justify it. Treasury bureaus are hereby authorized to issue such items to secretaries and staff assistants as may be approved by the bureau head, either on an individual case basis or a broad operating policy basis. However, the authority to issue executive type furniture shall not be used as the sole basis of upgrading existing furniture that is still serviceable.

d. Typewriters. Government procurement officers are required to purchase the lowest priced item that will fulfill the agencies' needs. The standard typewriter is the type-bar printing model. Requests for other than the lowest priced electric typewriters or for those machines with dual-pitch or any other unusual feature must be supported by justification for the expenditure of the additional funds.

e. Personal Convenience Items. Except as may be otherwise provided by law, Treasury bureaus shall not expend public funds for pictures, objects of art, plants or any other similar items intended solely for the personal convenience or to satisfy the personal desire of an official or employee. As described in FPMR 101-26.103-2, these items fall into the category of "luxury items" since they do not contribute to Treasury's mission. However, such items may be purchased when they are included in a plan for the decor of a Federal Building approved by the agency responsible for the design and construction.

f. Supply Activity Report IRC No. 1220-GSA-AN. FPMR Subpart 101-25.48 and Section 101-25.4902 provide guidance on the requirement for submission of the Supply Activity Report and instructions for completing the General Services Administration's (GSA) Form 1473. As required by paragraph 5a of this directive, this report is to be submitted to the Assistant Director, Office of Administrative Programs (Procurement and Personal Property Management) by November 15 of each year for Departmental transmittal to GSA.

7. UTILIZATION AND DISPOSAL OF PERSONAL PROPERTY.

a. General. Policies and guidelines governing the utilization and disposal of personal property appear in FPMR Parts 101-42 through 101-46 and 101-48.

b. Nonappropriated Fund Personal Property. Nonappropriated fund personal property determined to be excess shall be made available for transfer, on a reimbursable basis, in accordance with the provisions of FPMR Part 101-43 and this directive. See FPMR 101-43.313-11 and 43.315-3.

c. Abandoned or Forfeited Personal Property. Any voluntarily abandoned or forfeited personal property retained by a bureau for its official use shall lose its identity as such. When it is no longer required for official use, it shall be reported as excess in accordance with the provisions of FPMR Part 101-48 and this directive.

d. Intradepartmental Transfers of Excess Personal Property.

(1) No personal property of a Treasury bureau, reportable or non-reportable, shall be transferred to any other Federal agency or the D. C. Government or donated to any authorized organization until a determination has been made that the property cannot be utilized by other Treasury bureaus. In general, the extent of inquiry would depend upon the value of the property and transportation considerations; as a minimum, Treasury bureaus in the same metropolitan area should be surveyed to determine if the property can be utilized before releasing it to another agency or organization or reporting it as excess to GSA.

(2) Periodically, the Office of Administrative Programs will request each Treasury bureau having a decentralized personal property management program to report the name, complete address and local telephone number of a personal property utilization specialist in each city in which GSA regional offices are established, as may be applicable to the particular bureau's field office locations. Bureaus operating a centralized personal property management program shall forward the same information with respect to the individual at the bureau's headquarters who is responsible for the utilization of excess property, with a listing of the GSA regional cities in which the bureau has field offices.

(3) The Office of Administrative Programs will prepare and distribute a composite directory of the utilization officers. This listing is to be used by the bureaus, including field offices, to determine the potential for reutilization of excess personal property within the Department prior to reporting the property to GSA.

e. Reporting Excess Personal Property. Section 101-43.4801 of the FPMR provides guidance regarding whether the property is reportable or non-reportable to GSA. Bureaus shall complete a Standard Form 120, Report of Excess Personal Property, for reportable property, in accordance with the instructions contained in FPMR 101-43.311 and forward it to the appropriate GSA office for the region (except for parts of Region 3) in which the property is located. However, the SF 120 for all reportable excess personal property located in the Washington, D.C. metropolitan area shall be forwarded to the Assistant Director, Office of Administrative Programs (Procurement and Personal Property Management) for review and for circulation to other Treasury bureaus prior to transmittal to GSA. Standard Form 120 is an operating supply document and is excluded from the requirements of interagency and internal reports clearance.

f. Reporting Excess or Exchange/Sale Automatic Data Processing Equipment (ADPE). Bureaus shall prepare a Standard Form (SF)120, Report of Excess Personal Property, in accordance with the instructions contained in FPMR 101-32.4702 and forward the SF 120 for all excess and/or exchange/sale ADPE, both Government-owned and leased, to the Assistant Director, Office of Administrative Programs (Procurement and Personal Property Management) at least 120 days prior to the anticipated release date for review and circulation to other Treasury bureaus prior to transmittal to GSA. A statement on the SF 120 or attachment thereto, shall be provided, certifying that the equipment is currently in use and under maintenance contract, OR a certification by the maintenance contractor of maintainability of the equipment. If excess ADPE is reported to GSA AFTER warehousing and/or discontinuing the maintenance contract, the reporting agency will be responsible for any refurbishment costs necessary to make the ADPE again eligible for a maintenance contract. Standard Form 120 is an operating supply document and is excluded from the requirements of interagency and internal reports clearance.

g. Operation Cleanup Campaign. GSA Bulletin FPMR A-19, dated December 22, 1967, provides guidance for "Operation Cleanup" campaigns which are conducted during the month of February biennially, except for the Washington, D.C. area where annual campaigns are held. Bureau occupying space in GSA-operated buildings shall designate to the GS building manager an appropriate official to authorize the release of exces supplies or equipment uncovered during the walk-through inspections tha are to be conducted. Bureaus located in Treasury-operated buildings ar to conduct their own walk-through inspections during the month of February. Personal property determined to be excess during this inspectio should be reported on SF-120 and annotated as "Operation Cleanup" to assure priority handling by the Office of Administrative Programs and GSA. Standard Form 120 is an operating supply document and is excluded from th requirements of interagency and internal reports clearance.

h. Exchange and Sale of Personal Property for Replacement Purposes, IRC No. 1528-GSA-AN.

(1) As required by paragraph 5b of this directive, a summary report of transactions completed under the exchange/sale authority is to be submitted in memorandum form to the Assistant Director, Office of Administrative Programs (Procurement and Personal Property Management) by November 30 of each year for Departmental consolidation and transmittal to GSA. Details are contained in Subpart 101-46.407 of the FPMR. Subpart 101-46.4801 lists those Federal Supply Classification Groups which are not eligible for exchange/sale. Data shall be arranged as follows:

Column 1: Two-digit Federal Supply Classification Group

Column 2: Acquisition cost of property exchanged or traded-in

Column 3: Acquisition cost of property sold

(2) This data shall be separated into two categories:

(a) the States of the United States, the District of Columbia, American Samoa, Guam, the Trust Territory of the Pacific Islands, and the Virgin Islands: and

(b) All other areas of the world.

i. Availability and Acquisition of Personal Property Excess to Other Agencies. Section 101-43.315-2 of the FPMR describes methods of obtaining information regarding the availability of excess property, such as personal contact with GSA and periodic review of excess property bulletins. In addition, current and future requirements for excess property may be submitted to the appropriate GSA regional office on GSA Form 1539 and, for the Washington, D.C. metropolitan area, a memorandum to the Assistant Director, Office of Administrative Programs, (Procurement and Personal Property Management). The memorandum will be circularized among Treasury bureau personal property utilization officers to determine if the requirements can be fulfilled from excess property not yet reported.

j. Transfer of Excess Personal Property Between Federal Agencies.

(1) Only after it has been determined (as specified in paragraph 7d above) that property is excess to the Department, will a transfer of excess property be made to other Federal agencies. Excess personal property may be transferred between Federal agencies by use of SF 122 "Transfer Order Excess Personal Property" (See FPMR 101-43.4901-122) or such other transfer order form approved by GSA. The requesting agency shall prepare and forward the original and three copies of the transfer order to the appropriate GSA regional office for approval. Prior approval is not required when the property involved is:

(a) Reportable under FPMR 101-43.311, but has not yet been reported to GSA and the total acquisition cost does not exceed $1,000; or

(b) Nonreportable under FPMR 101-43-311, and has not been set aside for screening by GSA and the total acquisition cost does not exceed $25,000; and

(c) The holding agency sends an information copy of the transfer order to the appropriate GSA regional office within 10 workdays from the receipt of the order.

(2) Under the provisions of Section 2, Executive Order 11672, June 1972, and FPMR 101-43.315-1, excess personal property may be transferred to the U.S. Postal Service (USPS), with prior approval by the appropriate GSA regional office. The above procedures shall apply, except, all excess property to be transferred to the USPS shall be on a reimbursable basis at the FAIR MARKET VALUE (what the property would be sold for if offered for public sale on a competitiye bid basis), and the proceeds shall be deposited into Treasury miscellaneous receipts. The SF 122 is an operating supply document and is excluded from the requirements of interagency and internal reports clearance.

k. Annual Report of Utilization and Disposal of Excess and Surplus Personal Property, IRC No. 0015-GSA-AN. As required by FPMR 101-43-4701(a) and paragraph 5c of this directive, an annual performance report of excess personal property, shall be submitted on SF 121, "Annual Report of Utilization and Disposal of Excess and Surplus Personal Property", to the Assistant Director, Office of Administrative Programs (Procurement and Personal Property Management) by November 15 of each year for Departmental consolidation and transmittal to GSA.

l. Annual Report of Excess Personal Property Furnished Non-Federal Agency Recipients, IRC No. 0154-GSA-AN. As required by Subpart 101-43.4701(c) of the FPMR and paragraph 5e of this directive, each bureau is required to submit a consolidated annual performance report, of personal property obtained as excess property, or as property determined to be no longer required for the purpose of the appropriation from which it was purchased, and subsequently furnished in any manner whatsoever within the 50 States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, and American Samoa, to any recipient other than a Federal agency. The report shall be a memorandum, submitted to the Assistant Director, Office of Administrative Programs (Procurement and Personal Property Management) by November 30 of each year for Departmental consolidation and transmittal to GSA. Negative reports are required. The first report shall be submitted for FISCAL YEAR 1978, and shall include the name and address of each recipient and the total Government acquisition cost of all property furnished to that recipient identified by two-digit Federal Supply classification group, and the purpose (or purposes if more than one purpose) for which property was furnished to the recipient; e.g., cost-reimbursement type contract, fixed-fee type contract, or project grant. The report shall reference FPMR 101-43.4701(c).

8. OFFICIAL FLAG OF THE DEPARTMENT OF THE TREASURY.

a. General Description. The Treasury flag, announced for official use effective July 1, 1963, has a background of Irish green, upon which is a shield resting upon an eagle, holding in its beak a scroll containing the words "The Department of the Treasury." The obverse side of the scroll is Old Glory Blue with black shadows; the letters are in white. The reverse side of the scroll is white with dark gray, gray and light gray shadows. The eagle faces to its right with its claws holding another scroll containing the numerals "1789" in white. The shield background, flanked by an oak branch on the right and an olive branch on the left, is yellow with brown outlines and yellow-orange shadows and contains on it a chevron of blue crested by 13 white stars. Beneath the chevron is a traditional Treasury key in white with light gray shadows. Above the chevron are balances in white with light gray shadows pivoting upon a blue anchor with the ring at the top. Flags for indoor display have a gold fringe.

b. Size and Material.

(1) For outdoor display, the size of the Treasury flag is 5 feet by 9 feet and 4 inches (5'-0" x 9'-4") and for indoor display, the size is 4 feet and 4 inches by 5 feet and 6 inches (4'-4" x 5'-6"). Printed miniature flags may be used at banquets, international activities, and for ceremonial purposes where they would be in good taste; they may also be used as awards as authorized by Treasury Personnel Management Manual Chapter 451 Incentive Awards Program, Subchapter VI.

(2) Nylon is used for making the flags both for interior display and for exterior display; and the designs on both flags are applied in conformance with military specification MIL-F-2692.

c. Entitlement.

(1) Indoor Display. The Treasury flag is authorized for display, usually with the National Flag, as property of the Department of the Treasury in the offices of the following officials:

(a) Office of the Secretary

The Secretary

Deputy Secretary

Under Secretaries and Deputy Under Secretaries

General Counsel and Deputy General Counsel

Assistant Secretaries and Deputy Assistant Secretaries

Assistants to the Secretary

Financial Attaches Representing Treasury Overseas

(b) Bureaus

Bureau Heads

Deputy Bureau Heads

Assistant Heads of Bureaus

Heads of Major Field Offices

(c) The Treasury flag may be displayed in reception rooms and lobbies of buildings in which major Treasury activities solely are housed.

(2) Outdoor Display. The Treasury flag may be displayed, usually with the National Flag, on buildings or grounds in which major Treasury activities solely are housed.

(3) Additional Entitlement. Heads of Bureaus may extend the entitlement of the flag in unique cases for individuals or locations, such as auditoriums. A copy of each determination of additional entitlement shall be sent to the Assistant Secretary (Administration). Determinations of unique cases of entitlement in the Office of the Secretary will be made by the Assistant Secretary (Administration).

d. Requisitioning.

(1) As required by paragraph 5d of this directive, all Treasury bureaus shall obtain their requirements for the Treasury flag from the Office of Administrative Programs. Each bureau is to determine its annual requirements for the flag and forward them to the Office of Administrative Programs by September 1 of each year for consolidated procurement. The Office of Administrative Programs will maintain a stock of these flags, which will permit bureau requisitioning of small unanticipated emergency requirements during the year.

(2) For annual requirements and small emergency requirements, purchase orders should be sent to the Assistant Director, Office of Administrative Programs (Procurement and Personal Property Management), Department of the Treasury, Washington, D. C. 20220.

(3) Bureaus should contact the Chief, Office of the Secretary Personal Property Branch for information regarding current price and availability of the Treasury flag.

9. OFFICIAL SEAL OF THE DEPARTMENT OF THE TREASURY.

a. General. The current seal of the Department of the Treasury was announced and authorized by Treasury Department Order No. 212 dated January 29, 1968. The following provides guidance on the use and display of the Treasury seal and is issued in order to provide the regulations necessary to prevent a violation of 18 U. S. C. 701. Normal official use includes the authorized affixation of the Treasury seal on documents and the reproduction of the seal on Treasury property, including stationery.

b. Wall Plaque.

(1) Description. A 15-inch diameter fiberglass wall plaque of the seal, produced in accordance with the drawings and specifications developed by the Bureau of Engraving and Printing (Drawing MC-5123-A, 5-8-68), is authorized for display as official Treasury property in bureaus of the Department. Bureau heads will determine the extent that the seals are to be authorized for display in offices under their supervision.

(2) Requisitioning.

(a) Treasury bureaus may obtain their requirements for the Treasury seal either from the Office of Administrative Programs for small quantities, or through their own procurement action for larger quantities; in the latter case, a copy of the above referenced drawing may be obtained from the Office of Administrative Programs.

(b) Purchase orders for small requirements of the seal should be sent to the Assistant Director, Office of Administrative Programs

(Procurement and Personal Property Management), Department of the Treasury, Washington, D. C. 20220.

(c) Bureaus should contact the Chief, Office of the Secretary Personal Property Branch for information regarding current price and availability of the wall plaque.

c. Other Than Normal Official Use. The use of the seal of the Department of the Treasury, bureau seals or other insignia used in a similar manner or as a substitute for a seal is approved for the following purposes:

(1) In the printing of calling cards which are for the official use of an employee. Attention is called to the prohibition in the printing regulations against the printing of calling cards at public expense and to the fact that certain bureaus may prohibit the use of such cards.

(2) In connection with the manufacture of personal items which are for sale to Treasury employees through employee organizations, where the use of the seal for such items has been approved by the Assistant Secretary (Administration) or by the head of the bureau.

(3) In the manufacture of plaques or other commemorative souvenirs for the presentation to employees or nonemployees who have rendered service to the Department and which have received prior approval from bureau or office head responsible for their distribution.

(4) Other usage of the seal as may be approved on a case-by-case basis by the Assistant Secretary (Administration) and by the General Counsel of the Treasury.

10. ANTIQUE FURNISHINGS, DECORATIVE ARTS AND OTHER ITEMS OF HISTORIC INTEREST.

a. Over the years, the Office of the Secretary has collected antique or traditional furnishings and decorative arts and other items of historic interest for use in the Treasury Building. Many of the pieces now in use date from the mid-nineteenth and early twentieth centuries. The design and style of the furnishings of these periods are most appropriate for use in an older building such as Treasury with its large rooms and high barrel vault ceilings. Some of the items have been in use continuously over the years, while others have been acquired from storage or by transfer from the various bureaus of Treasury.

b. The Office of the Secretary has a continuing interest in expanding its collection by obtaining some of the older furnishings located in bureau headquarters or field offices which were used in the past but are now in storage. Of particular interest are older desks, tables, couches, chairs, portraits, paintings and similar items of historic significance which could be used as is or after restoration.

c. Bureau personal property officers should advise the Assistant Director, Office of Administrative Programs (Procurement and Personal Property Management) of any items of this type which are available for transfer. A brief description of each article should be included in the notification. Arrangements will be made for the transfer of property if it is determined that the item can be used in the Treasury Building.

11. OFFICE OF PRIMARY INTEREST. Office of Administrative Programs, Office of the Assistant Secretary (Administration).

William J. Beckham, Jr.
Assistant Secretary (Administration)

TRAVEL COSTS

Question: Last year the Congress required a $500,000,000 reduction be made to fiscal year 1980 travel expenditures. How much of this reduction was allocated to Treasury? Please provide a table indicating how much each of the bureaus were required to accept as travel reductions.

Answer: The total obligations for travel and transportation of things in fiscal year 1980 for the Treasury Department was reduced by $13.4 million from the President's initial 1980 budget estimates. The table listed below provides a breakdown, by bureau, of these reductions.

(In Thousands of Dollars)

Bureau	Direct Appropriation	Reimbursables	Net Departmental Reductions
Office of the Secretary	$ -42	$ -39	$ -81
International Affairs	-92	-98	-190
Office of Revenue Sharing	-87	---	-87
Federal Law Enforcement Training Center	-174	---	-174
Government Financial Oper.	-60	2	-58
Alcohol, Tobacco and Firearms	-565	65	-500
U.S. Customs Service	-1,131	-1,023	-2,154
Engraving and Printing	+78	---	+78
Bureau of the Mint	-27	-14	-41
Bureau of the Public Debt	-157	---	-157
Internal Revenue Service	-6,860	122	-6,738
U.S. Secret Service	-750	-78	-828
Comptroller of the Currency	-2,460	---	-2,460
TOTAL	$-12,327	$-1,063	$-13,390

Question: Will these reductions have any appreciable program impact? If so, what are they?

Answer: The FY 1980 travel reductions have affected all Treasury bureaus in various ways. Across the board, each bureau has had to devise and implement even more stringent control and approval procedures on an individual basis at the highest feasible review level. Every bureau has had to defer to greater use of long distance phone calls, conference calls and sending fewer personnel on trips when on-site presence would be more effective. Not only have the Congressionally imposed travel reductions impacted the numbers and kinds of trips allowed, but the rising costs of fuel, transportation and accommodations have lessened the number of trips taken. Those large, decentralized bureaus whose missions are dependent on travel such as the Mint, Customs, IRS, and Alcohol, Tobacco and Firearms have had to cancel supervisory technical and legal oversight related trips. Travel for the purpose of training has been severely curtailed which adversely impacts productivity and effectiveness of those personnel whose work requires a high level of technical competence. Most permanent change of station moves have been curtailed or delayed which will ultimately lead to appointment of less qualified personnel to management positions. Management conferences/seminars not considered vital to mission effectiveness have been cancelled along with all travel cost activities that do not severely impact the highest priority programs.

ADMINISTRATIVE SUPPORT PROGRAMS

Question: For each of the bureaus within the Department, what percentage of their total resources requested for fiscal year 1981 are for administrative support services (i.e., overhead)?

Answer: The following table displays what percentage of each bureaus budgeted resources are for administrative support services:

Bureau	Percent Administrative Costs
Office of the Secretary	7 percent
International Affairs	7 percent
Federal Law Enforcement Training Center	18 percent
Government Financial Operations	7 percent
Alcohol, Tobacco and Firearms	9 percent
U.S. Customs Service	12 percent
Bureau of the Mint	16 percent
Bureau of the Public Debt	4 percent
U.S. Savings Bonds Division	7 percent
Internal Revenue Service	19 percent
U.S. Secret Service	4 percent
Comptroller of the Currency	9 percent
Bureau of Engraving and Printing	21 percent

OFFICE OF THE INSPECTOR GENERAL

Question: For each of the bureaus and agencies in the Department, please provide a listing of audit and investigation resources expected to be available in fiscal year 1981.

Answer: Audit and investigation resources anticipated by bureau are displayed as follows:

Bureau	Audit (Positions)	Investigation (Positions)	Inspection (Positions)	Dollars ($000)
Office of the Secretary	12	6	—	660
Fed. Law Enforce. Trng. Cen.	1			20
Government Financial Oper.				
Alcohol, Tobacco & Firearms	22	21	—	
U.S. Customs Service	130	118	17	9,185
Bureau of the Mint	17	—	—	496
Bureau of the Public Debt	25			651
U.S. Savings Bonds Division	—	—	—	—
Internal Revenue Service	546	495	—	32,818
U.S. Secret Service				
Engraving and Printing	25	3	—	750
Comptroller of the Currency	13	—	—	308

1980 SUPPLEMENTAL REQUEST FOR INCREASED PAY COSTS

Question: The Department has proposed to absorb $31.5 million of the increased pay costs for fiscal year 1980, or apprixmately 23 percent of the total requirement. In view of the fact that IRS represents approximately 65 percent of the resources of the Depar -ment, why are they absorbing only 6 percent of their pay cost requirements? Please list the other mandatory increases that IRS is proposing to absorb in fiscal year 1981 (i.e., increases in travel, per diem, and health benefits). Considering their other items, what is IRS' aborption rate? (13 percent)

Answer: The Pay Act for 1980 approved a higher percent increase than in 1979. The Internal Revenue Service is already absorbing some $13.5 million of the 1980 pay supplemental as indicated below:

	(Amount in Thousands)
FY 1979 Net Pay Raise (5.5%)......................	$ 69,836
Equivalent 1980 Pay Raise (7.0%) on 1979 base....	89,000
Additional Pay Increase over 1979. Reflects larger workforce and allowance for higher limitation on executive salaries.................	23,686
FY 1980 Pay Raise (7.0%) Estimate................	$ 112,686
Initial OMB Pay Supplemental Reduction...........	- 6,534
Recent Hiring Freeze Assessment (President's Revised Budget)	- 6,966
FY 1980 Pay Supplemental Now Pending in Congress.	$ 99,186
Pay Raise Absorption Already Proposed............	$ 13,500
Percent Pay Raise Absorption Already Proposed....	12%

In addition to absorbing $13.5 million of the pay supplemental, the Internal Revenue Service has also had to absorb:

Employer share of employee's health benefit premium increase..	$ 3.4
Increase travel costs....................................	6.8
Increase above budgeted amount of printing tax packages and returns for 1979..	6.0
Out-of-pocket start-up costs to implement the Crude Oil Windfall Profits Tax of 1980..............................	.6
Out-of-pocket start-up costs to implement collection of revenues for the Northern Mariana Is.......................	.1
Unfunded cost of Taxpayer Compliance Measurement Program (TCMP) data Tabulation covering tax year 1976..............	1.0
Total Unbudgeted costs increases absorbed in FY 1980	$17.9

Question: Last year's pay increases were $80.6 million (Page 185 Senate Hearing Record). This year's net pay cost requirements are $140.5 million, or a 74 percent increase over last year's net pay cost requirements. As personnel increases in 1980 were relatively minimal on a percentage basis compared to the 1979 personnel levels, why are net pay increases escalating so rapidly?

Answer: The FY 1979 net pay increase of $80.4 million does not reflect a number of actions that were applicable only to FY 1979 pay costs. Specifically, they are: (1) a $4.0 million FY 1979 Congressional adjustment for U.S. Customs pay; (2) a one-time $12 million savings in the Bureau of the Public Debt tax and loan account which helped offset the total to pay costs of the Department; and (3) significant savings realized from last year's hiring freeze imposed early in fiscal year 1979) which were also applied to the total pay requirements. As a result of the above items, the FY 1979 total pay requirements actually exceeded $100 million although we requested only $80.4 million in net appropriations. In addition, the FY 1980 pay raise of 7.0 percent represented a 27.3 percent increase over the FY 1979 pay raise level of 5.5 percent.

Question: Could the Department absorb another 5 percent of this total requirement?

Answer: The pay costs already absorbed by the Department represents nearly a 20 percent reduction to FY 1980 total pay costs. These reductions cover such items as increased travel costs, health benefits, fuel, printing, etc. The attached chart displays the extent of pay costs absorbed. The imposition of another 5 percent could not be absorbed without cutting into program and mission effectiveness. Also a 5 percent reduction this late in the fiscal year would result in a significantly higher reduction in our programs than if we had the entire year to identify savings.

DEPARTMENT OF THE TREASURY

Fiscal Year 1980 Increased Pay costs

(Dollars in Thousands)

	Total Pay Costs Requirements	Amount Absorbed	Net Pay Costs (Excluding) Proposed Transfers)
Office of the Secretary	2,177	686	1,491
International Affairs	1,154	705	449
Federal Law Enforcement Training Center	508	109	399
Government Financial Operations	3,277	3,277	---
Alcohol, Tobacco and Firearms	6,601	1,382	5,219
U.S. Customs Service	28,468	6,315	22,153
Engraving and Printing	4,770	4,770	---
Bureau of the Mint	2,196	1,565	631
Bureau of the Public Debt	2,875	259	2,616
Internal Revenue Service:			
Salaries and Expenses	8,302	627	7,675
Taxpayer Ser. & Returns Proc.	35,012	2,819	32,193
Examinations & Appeals	43,840	2,266	41,574
Investigations & Collection	26,331	1,621	24,710
Total IRS	113,485	7,333	106,152
U.S. Secret Service	7,108	8	7,100
Comptroller of the Currency	5,110	5,110	---
Subtotal	177,729	31,519	146,210
Proposed Transfer to the Secret Service of Mint Construction Acct Balance	---	---	-5,730
TOTAL	177,729	31,519	140,480

QUESTIONS SUBMITTED BY SENATOR SCHMITT

SENATOR SCHMITT: What would be your reaction to a 2 percent to 10 percent cut? What adverse impact would it have?

SECRETARY MILLER: I am particularly concerned about the impact of a 2 percent to 10 percent reduction to the Internal Revenue Service because the reduction will not only have an impact on the Services' revenue collection abilities and maintenance of a high degree of voluntary compliance which is crucial to the nation's tax system, but it also will result in a reduction in receipts to the Treasury on the order of five to eight times the amount of the cut. Thus, in order to save around $50 million, this type of indiscriminate reduction will in all likelihood result in a revenue loss to the United States of between $250 to $400 million.

I am similarly concerned about the result of an indiscriminate cut on the funding of the Bureau of Government Financial Operations, which is primarily a fixed cost operation with large amounts of resources devoted to postage and reimbursements to banks. The absorption of this type of reduction could jeopardize a part of the bureau's primary mission of check disbursement.

As you know, Treasury is primarily a service agency and to the extent the bureaus are arbitrarily reduced, significiant reductions in services can result. For example, the U.S. Customs Service is experiencing workload increases in both processing and interdiction; the U.S. Secret Service is in the midst of its protection responsibilities for the 1980 Presidential campaign; the Bureau of the Public Debt must continue to process increasing amounts of securities; and a major reduction in the Bureau of Alcohol, Tobacco and Firearms will seriously jeopardize the bureau's revenue collection and criminal enforcement responsibilities. Similar increases in workload are facing the other Treasury bureaus as well.

Q. The New York Times of April 6, 1980, reported that you saw "the beginning hopes" that the U.S. is winning its fight against inflation. You also stated, according to the Times, a recession has begun and that it could be "a little more severe" than the Administration forecasts.

What is your forecast for the rate of inflation at the end of 1980 and how much of a recession do you foresee? What, for example, do you estimate the prime rate will be next December, the unemployment rate by then, and the rate of inflation?

ANSWER:

In the outlook for inflation, signs are emerging of a significant slowing in the rate of increase in prices. Such signs are most evident among prices of traded commodities for which some speculative increases early in the year have been reversed. Signs of easing in the rate of advance of prices of semi-finished goods have also emerged. Progress will be less rapid in bringing down the rate of increase of the consumer price index, partly because mortgage interest rates carry a heavy weight and are incorporated into that index with some lag. By the latter months of the year, however, all these factors will lead to a marked improvement in the CPI. A strong likelihood exists that it will be increasing late this year at less than a double-digit rate.

Such moderating of inflation will, of course, be welcome, but the built-in momentum of the inflationary process implies that the rate of increase of prices late this year and in 1981 will remain unacceptably high. We must set a long-run course that will gradually wind down the rate of inflation and adhere to that course.

The Administration forecast made in March was for a mild recession, with the unemployment rate reaching about 7-1/4 percent toward the end of 1980 and increasing a bit more in 1981. Since the time of that forecast, measures of economic activity show a somewhat more rapid deceleration than had been expected by forecasters, both within and without the Administration. Of course, the unemployment rate could move higher than projected. Nevertheless, there are a number of cushioning influences that should moderate the economy°s decline. Most notable among these is the relatively restrained inventory policies which businesses generally followed throughout the expansion. Additionally, the latest expansion was not marked by the degree of excesses in commercial or residential construction, in business capital spending generally, or in consumer durable goods purchases which preceded some previous downturns. Needless to note, we will be monitoring the course of economic activity very closely in the months ahead.

Market rates of interest have been moving down sharply since reaching peaks at the end of March. Since Treasury Department financing is a major factor in money and capital markets, it would not be appropriate to make a point estimate of the prime rate at year-end. However, the prime rate has not gone downward as rapidly in recent weeks as market rates, and some further declines in the prime rate might be expected. Declines would be consistent with the somewhat weaker pace of economic activity anticipated for the period ahead.

Q. Inflation, as measured by the consumer price index, has been running at an annual rate of 17% over the past three months. In other words, didn't the Administration blow it again in economic policy?

ANSWER:

The consumer price index rose in March by 1.4%, the third consecutive monthly increase at that rate. These translate into an annual rate increase of about 18% during the first three months of the year. It is generally recognized that the consumer price index is currently somewhat overstating the true rate of inflation. For example, the price deflator for personal consumption expenditures, regarded by many economists as a better measure of inflation on consumers, rose at a 12.6% annual rate during the first quarter or 14.0% on a fixed weight basis. In terms of the entire economy, the GNP price deflator rose at a 9.5% annual rate in the first quarter, or 11.4% on a fixed weight basis.

By any measure, inflation is an extremely serious problem. This fact was recognized in the intensive anti-inflation program announced by President Carter on March 14. Since the announcement of that program, short-term interest rates have fallen dramatically and sensitive materials price indexes have been dropping. There are no quick answers to inflation and above all no painless answers. However, economic policies have been adapted and are making a strong contribution to the control of inflation.

Q. Does the Administration's recent conversion to balanced budgets mean the Keynesian doctrines--which have dominated thinking in government for the past 40 years--are now moribund?

A. What occurred in the 50 days between the late January submission of the federal budget and mid-March when the Administration radically shifted its budget policy?

B. Can we expect more shifts in coming months? If so, what kind?

C. Isn't it true that the Administration feels that the only way a balanced budget can be attained in Fiscal 1981 is by tapping new revenue sources? Is that the dominant reason for instituting the crude-oil import fee, demanding excise tax on domestic oil, and applying withholding to interest and dividend payments?

D. Indeed, isn't a rising tax burden at the heart of the Administration's budget-balancing effort? On the basis of the March 14 package, total Federal tax collections are expected to rise by 15% in the current fiscal year and by a further 17% in fiscal 1981--a two-year increase of almost $160 billion. In taxing people further, aren't you compounding the chances for a more severe recession?

E. Isn't the increasing tax burden a consequence of the government's failure to slow the rise in transfer payments?

ANSWER:

A. Between the end of January and mid-March, inflationary pressures intensified and financial market expectations worsened. This was a joint result of international tensions and domestic economic developments. In January, three major private econometric forecasting services were projecting negative growth for the domestic economy. As the quarter progressed, it became apparent that the economy was stronger than expected. There were few signs that the inflation rate would fall back spontaneously. This reacted adversely on the financial markets and interest rates rose sharply. Under the circumstances, it was necessary to strengthen the inflation program and reduce inflationary expectations.

B. No drastic shifts in economic policy are contemplated. The control of inflation requires steady policies which will gradually achieve their objectives. On the other hand, some adaptation to changing economic circumstances is essential since economic forecasts are sometimes inaccurate and misleading. But, at the present time, the full weight of the policy effort is being directed to the control of inflation.

C. The Administration is aiming at a balanced budget and has recommended a set of expenditure reductions which would achieve that result. President Carter pointed out in his March 31 message to the Congress that receipts from the gasoline conservation fee and the proposed withholding of taxes on interest and dividends would not be used as a substitute for necessary spending cuts. Rather, these receipts will give the budget a margin of safety. This will ensure that the budget will remain in balance if estimates change in a way that cannot be predicted now.

D. The elimination of the 1981 deficit since January reflects several factors. On the outlay side, revised economic conditions and technical reestimates, taken alone increased estimated outlays by $13.0 billion. Expenditure reductions of $17.2 billion have been proposed which results in an outlay estimate of $611.5 billion for 1981. On the receipts side, the revised economic outlook and congressional action on the windfall profits tax increase receipts by $12.0 billion. Proposed tax changes affecting gasoline and the withholding of taxes owed on interest and dividends will increase total receipts to $628.0 billion.

As indicated, the final outcome results from a range of influences rather than simply from a rising tax burden. The Administration is concerned over the height of taxation but from the point of view of long run economic structure and productive efficiency. It is important to recognize that the tax receipts in question are generated along the path that the economy is expected to follow. Therefore, those same tax receipts could not logically be regarded as an independent influence which might compound the chances for a more severe recession.

E. An increasing tax burden might more properly be regarded as a consequence of the failure to slow the rate of inflation, particularly since many transfer payments are linked directly to inflation, e.g., social security benefits, and other such payments are indirectly affected by inflation, e.g., interest on the national debt. In the last analysis, all government outlays must be covered by tax receipts if the budget is to be balanced and singling out any outlay category as the cause of higher taxes is somewhat arbitrary. However, it is true that transfer payments are growing rapidly. Between 1979 and 1981, payments to individuals (directly and through states and localities) will account for $77.8 billion of the total $117.8 rise in federal outlays. This will increase the payments to individuals share of total outlays from 48.2% to 51.6%.

Q. With the new credit controls, will small business and farmers who typically do not have lines of credit -- find that their bank's leeway in lending is used up honoring claims of customers who have established lines? Will farmers be short of cash for spring planting.?

ANSWER:

There may be isolated incidents of strain for small business and farm borrowers as a result of the new credit controls. However, the Federal Reserve has taken two actions which should alleviate most of the strain on these groups.

1. Credit to farms and small business, while still under the general 6-9 percent credit growth limitations, is considered to be a "preferred" type of credit in the bank's decision as to which loans should be undertaken;

2. The preferential lower discount rate announced by the Federal Reserve for banks meeting "seasonal" loans applies to small business credits as well as to agricultural credit provided (a) that the bank has less than $100 million in deposits, (b) that it has liquidity problems as indicated by a loan-to-deposit ratio in excess of 70 percent, and (c) that it has been giving proper preference to such loans in the period already covered by the program. The special discount facility will then help meet up to 70 percent of such credits.

Both of these actions should lessen any unduly burdensome effects of the new credit control on small business and farmers and should, in particular, insure that farms will be able to finance their spring plantings.

Q. As things are now shaping up, we are facing a deteriorating economy marked by widespread layoffs. Currently there are some 160,000 on layoffs in the auto industry. Bureau of Labor Statistics studies show that for every auto production worker unemployed, nearly three additional workers in auto-related industries are affected. On this basis a loss of 160,000 auto industry jobs entails a total loss of some 600,000 jobs. Housing also is deeply affected with housing starts expected to be only a little over half this year compared to 1978. (About 1.15 million compared to 2 million in 1978.) Since tax revenues decline and expenditures increase with a recession, won't any hope for balancing the budget go out the window? With the economy in recession, isn't the Administration likely to switch course again and call for a tax cut?

A. Would such a tax cut be designed to stimulate consumption or to stimulate capital formation and productivity growth? Would such a tax cut include liberalized depreciation and a cut in corporate tax rates? (Recent productivity growth has been negative and for years has been the lowest among the industrialized nations.)

ANSWER:

We will be monitoring the course of the economy very carefully in the months to come. We have placed high priority on achieving budget balance. Clearly, however, there are times when a balanced budget is inappropriate, and if economic activity deteriorates seriously from the course we have projected, then alternative steps may be necessary.

Should fiscal action become warranted on the basis of altered economic conditions, such actions must be consistent with a longer run strategy of winding down the rate of inflation and fostering conditions which lead to an improved economic performance. In such circumstances, measures to stimulate capital formation and productivity growth would receive careful consideration.

QUESTION: Inflation is particularly attractive to Presidents because it raises additional revenues. For example, tax revenues increased from $194 billion in 1970 to an estimated $509 billion in 1980 without the President or the Congress ever having to ask for or support a single tax increase. Therefore, why shouldn't we reduce tax brackets every year by the amount of inflation suffered in the previous year in order to be intellectually honest with the American people?

ANSWER: We are aware that inflation causes higher tax burdens. In the past years, a series of legislated income tax cuts has largely offset these inflation-induced tax increases. However, currently in order to solve the increasingly serious problem of inflation, the Administration is making a major effort to bring the budget into balance. This requires both postponing desirable tax cuts as well as reducing or eliminating some worthwhile spending programs. We are hopeful that in future years the budgetary outlook will improve so that we will again be able to propose tax cuts and reduce overall tax burdens.

Question: In the moves against Iran, the Administration froze Iranian assets in the United States. Now it is seeking to determine claims against these assets. Are these assets sufficient to prevent large losses by American Banks and other creditors?

Answer: The President announced on April 7th that the Treasury Department would conduct a formal census of claims of U.S. nationals against Iran and of the assets blocked under the November 14th order. The required census forms must be filed by May 15, 1980. Until this information is received, it is difficult to determine whether the blocked assets exceed the claims of various U.S. nationals. The President will be submitting legislation to the Congress shortly which is intended to provide a framework for addressing these issues.

QUESTION: Certain Congressmen have considered introducting bills requiring that all future Treasury bonds offered for sale to the public be Guaranteed Purchase Price Bonds. In other words, if Treasury sells a bond in 1980 maturing in 1990 for $1,000 and in the interval the dollar depreciates 50% on account of inflation, the matured bond should be redeemed at $2,000. Mr. Secretary, will you share with the Committee your thoughts about these Guaranteed Purchase Price Bonds, and whether or not you support this concept?

ANSWER: The subject of indexing the interest return and the maturity value of Treasury securities has come up from time to time over the years, especially during periods of significant inflation. Such proposals pose a number of difficulties:

-- Indexed bonds would contribute to the growth of inflation rather than eliminating it. The issuance of indexed obligations would require us to respond to inflationary developments by increasing payments to investors, and related Federal outlays, at a time when there should be restraint on Federal spending. Indexed Treasury bonds, therefore, would add one more escalator to the mechanism by which the dynamic process of inflation is speeded through the economy.

-- Indexed Government securities would discriminate in favor of certain investor groups at the expense of taxpayers, and provide benefits to holders of a particular form of investment at the expense of other savers and those with no savings, particularly low-income groups who would be unable to hedge against inflation through the proposed bonds.

-- Indexed Federal Government securities would also be disruptive to existing financial practices and to the operations of a wide variety of financial institutions. Contracts expressed in fixed numbers of dollars constitute a necessary and desirable part of the foundation of our social and economic system. The efforts of the Government must be devoted to preserving the integrity of this foundations rather than toward providing a substitute that could result in a major upheaval in existing arrangements.

Thus, rather than attempting to insulate certain investor groups from the impact of inflation, we should concentrate our efforts on controlling inflation through fiscal discipline and monetary restraint.

There is an old maxim in government that "spending rises to meet the amount of money available to spend." What would you think if the Congress passed laws that would limit the budget to a certain percentage of the GNP?

ANSWER

Spending limitations are likely to raise more problems than they solve. To the extent that they in fact limit spending, they do so in ways that may impair economic stabilization policy. At the same time, they complicate efficient management of Federal governmental activities. Whether they would in fact limit spending, however, is problematic, since there are numerous ways that the spending limits could be avoided, many of which would contribute to reduced economic efficiency. Even if spending limits turned out to be relatively harmless, they would likely give rise to an annual Congressional process comparable to that accompanying the Federal debt ceiling.

QUESTION: What is your position with respect to relieving dividends of the burden of double taxation?

ANSWER: The Treasury has studied proposals to integrate, at least partially, the corporate and individual income taxes by allowing credits for dividends to the shareholders, the corporations, or both. I think it is fair to say that the business community has not enthusiastically embraced such proposals in the recent past. Especially in a period of severe budget constraint, other measures to reduce the burden of taxation on corporate income would have a higher priority. Perhaps this is an issue that should be re-assessed, however, as part of any long-range tax policy planning.

QUESTION: What would be the impact in terms of administration, compliance, revenues, etc., if we simplified the Tax Code? I am specifically thinking about a Tax Code without most of the present deductions and one with a lower rate of tax on total income?

ANSWER: Generally a broad-base low-rate alternative to the present income tax structure is primarily considered to provide equity and economic efficiency rather than simplification and less costly administration. Nevertheless, that approach while serving other goals would facilitate easier interpretation of the tax laws and would reduce administrative costs. It would make it unnecessary for higher income taxpayers to engage in complex and often questionable transactions and exchanges in order to reduce their marginal tax rates. It would reduce the need for laws, regulations and administrative procedures to deal with tax avoidance and abuse of tax incentives.

It should be pointed out, however, that a broad base low-rate alternative would not always create simplification. For example, if the broad base includes government transfer payments and incomes-in-kind which are not now included in income, then complexities would be added to the Code, more returns would have to be filed, and administrative costs would be increased.

The revenue impact of such a tax structure depends on the specific decisions made. One could decide, for example, on an alternative which has no aggregate revenue impact by simply structuring the tax to offset the increases generated by expanding the tax base. These would, of course, be many individual gainers and losers under this system. A further reduction of tax rates may avoid much of the tax increases for taxpayers, but would also generate net revenue losses.

QUESTION: What is your position on the proposal for a value-added tax?

ANSWER: The issues involved in adopting a value-added tax should not be minimized. A scope of the value-added tax would be a major change in the Federal tax structure and would have to examine carefully the equity, efficiency, and administrability of the resulting tax system. As I indicated in my testimony before the Ways and Means Committee on November 8, 1979, value-added tax proposals, such as the one made by Chairman Ullman in the "Tax Restructuring Act of 1980" (H.R. 7015), require and deserve careful and deliberate study. The Treasury Department welcomes the opportunity to participate in that study.

QUESTION: Could you tell this Committee what the growth of taxes, particularly additional taxes, has been over the past decade as compared with the growth of the GNP?

ANSWER: The following table shows receipts, by major source, as a percent of gross national product for each of the past ten years, 1969-1979.

Total receipts were 20.8 percent of GNP in 1969 and 20.1 percent ten years later. Since 1976, total receipts have steadily increased on a percent of GNP, rising on average about one-half of a percentage point per year from the 1976 low of 18.5 percent. The relatively high ratio of receipts to GNP at the beginning of this ten-year series is explained, in part, by the temporary income tax surcharge which applied to both individual and corporation income taxes.

Attachment

Percentage Distribution: Receipts by Source as a Percent of GNP, 1969-1979

Fiscal Years

Fiscal year	Individual income taxes	Corporation income taxes	Social insurance taxes and contribtions	Excise taxes	All other receipts	Total receipts
1969	9.7	4.1	4.4	1.7	1.0	20.8
1970	9.4	3.4	4.7	1.6	1.0	20.2
1971	8.5	2.6	4.8	1.6	1.0	18.5
1972	8.5	2.9	4.9	1.4	1.1	18.8
1973	8.3	2.9	5.2	1.3	1.0	18.8
1974	8.8	2.8	5.6	1.2	1.0	19.5
1975	8.4	2.8	5.9	1.1	1.0	19.3
1976	8.1	2.6	5.7	1.0	1.1	18.5
1977	8.6	3.0	5.9	1.0	1.0	19.4
1978	8.8	2.9	6.0	0.9	0.9	19.5
1979	9.4	2.8	6.1	0.8	1.0	20.1

Office of the Secretary of the Treasury
Office of Tax Analysis

April 30, 1980

Source: Office of Management and Budget, Federal Government Finances, January 1980 Edition.

Q. What is your position on wage and price control? Does the Administration plan to ask for legislative authority to impose wage and price controls.

Answer:

The Administration is opposed to wage and price controls and does not plan to ask for any such legislative authority.

QUESTION: Regarding dividend and interest withholding:

2 (a) Can you tell us the number of people who don't have to pay any income tax, but would have withholding on dividends and interest?

ANSWER: The proposal allows nontaxable persons to file exemption certificates and, thus, not to be withheld on interest and dividend income.

QUESTION:

2 (b) Is the Document Matching System failing?

ANSWER: The Document Matching System is not failing. The System provides useful information to the Internal Revenue Service on amounts of interest and dividends received by individuals and discourages the underreporting of income. The Internal Revenue Service now matches at least 72 percent of the information documents that it receives on interest and dividends and uncovers several million discrepancies.

Nonetheless, the results of the recent Internal Revenue Service report on unreported income clearly indicate that, even with the additional reporting requirements enacted in the Revenue Act of 1962, taxpayers still fail to report and pay tax on significant amounts of taxable dividends and interest for which information reports are filed. Much of the nonreporting is apparently due to inadvertance, forgetfulness and failure to keep records, particularly by taxpayers who receive relatively small amounts of dividend and interest income. Other nonreporting is due to nonfilers who owe some tax but are difficult to trace. To follow up on all of these leads would require millions of telephone calls, letters and visits. This would inevitably be regarded as harassment of "little people".

Moreover, the cost of following up the millions of discrepancies is demonstrably uneconomical. Even extensive pursuit of taxpayers would not achieve full collection of unpaid taxes. There would be many unfruitful investigations where taxpayers cannot be reached by telephone or traced if they have moved. Even after the taxes have been assessed, it would be impossible or uneconomical to collect them.

QUESTION:

2 (c) What is the impact on the public and government of dividend withholding in terms of additional paperwork?

ANSWER: The impact is minimal. Eighty-seven percent of the interest and dividends covered by the proposal is already subject to information reporting. For these, withholding agents need only add the amount of withheld tax to the reporting statement, remit the withheld tax to the Internal Revenue Service, and adjust the payments to the payee accordingly. Although withholding will be extended to instruments for which there is now no reporting, most of them are bearer securities held by corporations, and corporate recipients are exempt under the proposal.

Naturally, there will be some start-up costs associated with adding withholding--there are always costs when an existing system is modified. But with a reporting system largely in place, we do not anticipate high continuing costs of the system to whithholding agents.

The principal new cost will result from the exemption system. In recognition of this, exemption certificates will be permanent until they are revoked.

Overall, however, withholding is a far better way to collect taxes than is an increase in the number of audits, record checks, and collection attempts by the Internal Revenue Service. All taxpayers would bear the cost of increased audit coverage through the higher taxes needed to pay for the personnel and equipment necessary to conduct thorough examinations of more returns. Perhaps more importantly, taxpayers would suffer the loss of privacy from more frequent audits, records checks and requests for detailed information. The success of the wage withholding system indicates that taxpayers prefer withholding as a way to pay their taxes.

QUESTION:

(3) Mr. Secretary, could you comment on the allegation that any tax increase would contribute to inflation?

ANSWER: Inflation can be caused by excessive demand, restraints on supply and by other forces such as OPEC. Tax decreases can lead to inflation if they cause excess demand; by the same token, tax increases can lead to inflation, at least in the long run, if they unnecessarily restrict supply. A balance must be achieved, and no simple rule will suffice. In the case of oil and gasoline, for instance, what is essential is that we restrict our demand enough that other countries cannot arbitrarily disrupt our economy and force inflation on us from the outside. If restricting demand requires a tax increase, then that is a cost we will have to incur today to limit inflation tomorrow. In the case of withholding on interest and dividends, the receipts of the government increase primarily because withholding will collect taxes from some persons not reporting their taxable interest and dividend income. There is no increase in tax liability for anyone. One would hardly want to restrict tax revenues by advocating less efficient enforcement or lower compliance with the tax laws.

Because of the currently high rates of inflation, it is vital that the government sector not stimulate demand unnecessarily by running a budget deficit. The President has proposed a pack age of expenditure and tax changes to achieve that objective and to help bring the rate of inflation under control.

SUBCOMMITTEE RECESS

Senator CHILES. With that, we will stand in recess until tomorrow at 10 a.m.

Thank you.

[Whereupon, at 12:20 p.m., Tuesday, April 15, the subcommittee was recessed to reconvene at 10 a.m., Wednesday, April 16.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1981

WEDNESDAY, APRIL 16, 1980

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, D.C.

The subcommittee met at 10:23 a.m., in room 1318, Everett McKinley Dirksen Senate Office Building, Hon. Lawton Chiles (chairman) presiding.

Present: Senators Chiles and Schmitt.

DEPARTMENT OF THE TREASURY

U.S. CUSTOMS SERVICE

STATEMENT OF ROBERT E. CHASEN, COMMISSIONER OF CUSTOMS

ACCOMPANIED BY:

- **RICHARD J. DAVIS, ASSISTANT SECRETARY, ENFORCEMENT AND OPERATIONS**
- **WILLIAM T. ARCHEY, DEPUTY COMMISSIONER OF CUSTOMS**
- **CHARLES C. HACKETT, JR., ASSISTANT COMMISSIONER, BORDER OPERATIONS**
- **GEORGE C. CORCORAN, JR., ASSISTANT COMMISSIONER, MANAGEMENT INTEGRITY**
- **ALFRED R. DE ANGELUS, ASSISTANT COMMISSIONER, COMMERCIAL OPERATIONS**
- **JACK T. LACY, COMPTROLLER**
- **RICHARD H. ABBEY, CHIEF COUNSEL**
- **KENNETH L. WILSON, DIRECTOR, PLANNING AND BUDGET DIVISION**
- **C. WAYNE HAMILTON, CHIEF, BUDGET BRANCH**
- **ARTHUR K. KALLEN, DIRECTOR, OFFICE OF BUDGET AND PROGRAM ANALYSIS, DEPARTMENT OF THE TREASURY**

OPENING REMARKS OF SENATOR CHILES

Senator CHILES. Today the committee will receive testimony from the U.S. Customs Service, the Bureau of Government Financial Operations, and the Bureau of Public Debt. The combined request for these three agencies for fiscal year 1981 is $798,556,000.

We will cover a number of matters with the U.S. Customs Service, including efforts to speed the entry of international visitors through our air and sea ports, the drug interdiction program at our borders, the alleged fraud and abuse disclosures in the Customs' New York region, the proposal to reduce the overtime pay cap to $15,000 a year per employee, and other matters.

We will talk with the Bureau of Government Financial Operations about the duplicate check problem which after 9 years and almost $4 million spent to correct the problem still exists and shows no remarkable signs of improvement. While the committee recognizes that this is an inherited problem, we do look to current management to help solve it.

With the Bureau of the Public Debt we will talk about the collapse in the Government savings bond program and the need to continue to make $36 million worth of payments to the Federal Reserve System when that organization has been enjoying $10 billion operating surpluses in recent years.

The committee will begin by receiving testimony from the U.S. Customs Service regarding the fiscal year 1981 budget request and the fiscal year 1980 supplemental request. For fiscal year 1981, $465,700,000 and 13,821 permanent positions have been requested which reflects a $6.3 million and 68 position reduction from the original January request. For the fiscal year 1980 pay increase supplemental, $22,153,000 has been requested.

The committee is pleased to have Hon. Richard J. Davis, Assistant Secretary of the Treasury for Enforcement and Operations, and Robert E. Chasen, Commissioner of Customs, with us today to present the testimony in support of these requests.

Senator Schmitt, do you have a statement?

OPENING REMARKS OF SENATOR SCHMITT

Senator SCHMITT. Thank you, Mr. Chairman.

Very briefly, I am particularly concerned about the Customs Service. There probably is no agency of Government with a responsibility that impacts so many people in our country as does the Customs Service. It has a tremendously important responsibility, not only to oversee the importation of various goods into the country through legal means but to try to assist other agencies in major ways, with major responsibility, in the interdiction of contraband, drugs in particular, that enter this country and are seriously undermining the health and welfare of millions of our citizens.

Frankly, Mr. Chairman, based on my research over this last year and the report on the air interdiction program that has been provided to the committee at our request, the Customs Service seems to be in organizational shambles. I don't know what the answer is, but we have to find an answer.

This subcommittee is in the unique position of not only being the appropriations committee but almost by default we are the authorizing committee, or at least the oversight subcommittee that looks at the Customs Service. I think we must look at it very carefully and very deeply because it is so important to the welfare of so many of our citizens. But, frankly, recent disclosures, as well as the internal workings of the Service, don't seem to be matching up to those responsibilities.

There is a large number of excellent personnel in the Customs

Service. There is no question about that. They are dedicated and hard-working people. In the face of adversity and difficult tasks, they are doing the best job I think they can.

We are going to have to fix it. How we can fix it I hope will be explored today and maybe in a subsequent hearing.

Thank you.

Senator CHILES. Thank you.

PREPARED STATEMENT

Mr. Davis, we will put your full statement in the record, if you would brief it for us.

[The statement follows:]

STATEMENT OF RICHARD J. DAVIS

It is a pleasure to apper before you today in support of the fiscal year 1981 appropriation request for the U.S. Customs Service. Appearing with me today are Robert Chasen, Commissioner of Customs, and his staff, and Arthur Kallen, Director, Office of Budget and Program Analysis for the Treasury Department.

The Customs Service has one of the most diverse and challenging missions of our various Government agencies. It is a law enforcement agency responsible for interdicting contraband at our borders and investigating such matters as Customs fraud, violations of the Currency Reporting Act and arms smuggling under the Arms Export Control Act. It is also responsible for enforcing this Nation's complex tariff laws and regulations. At the same time, while carrying out its enforcement mission, the U.S. Customs Service is also a Good Will Ambassador facilitating international trade and travel. In meeting its mission for fiscal year 1979 the U.S. Customs Service processed 270 million persons, 4.4 million formal entries and collected $8.5 billion in revenue. It seized 208 pounds of heroin, 2,208 pounds of cocaine, and nearly 52,000 pounds of hashish.

For fiscal year 1981 the U.S. Customs Service is requesting an appropriation of $465,700,000 as amended by the President's revisions of March 1980. This is an increase of $1.4 million over the proposed authorized level for fiscal year 1980. The fiscal year 1980 supplemental request for the pay increase effective in October 1979 is $22,153,000. The fiscal year 1981 appropriation request does not include any resources for the antidumping and countervailing duty programs which were transferred to the Department of Commerce on January 2, 1980.

We believe the resources requested will permit the U.S. Customs Service to carry out its mission in a satisfactory manner. Productivity gains will assist in offsetting workload increases. The Customs Service continues to improve utilization of its resources through new methods and greater use of technology including data processing. New ways for processing passengers are being implemented such as Citizens By-Pass and One-Stop inspection which will improve productivity methods for improving the effectiveness and efficiency of cargo inspection are being developed and evaluated. The U.S. Customs Service is continuing its efforts to identify and eliminate unnecessary and duplicate supervisory and administrative positions which have developed over time.

The Customs Service has also developed an aggressive program to assure that the business of the Service is conducted in as honest a manner as possible. This program recognizes that it is the responsibility of Government agencies to fight corruption within their own organization. While adoption of such a program may produce short-term "pain" as a result of prosecutions and disciplinary proceedings, it is necessary if, in the long run, there is to be public confidence in Government. Commissioner Chasen deserves credit for his complete dedication to integrity programs.

The U.S. Customs Service faces a constantly changing workload as trade and travel patterns change. In order to manage in this environment they need long-range planning in order to best allocate limited resources as well as develop programs to meet the varying workload demands. The U.S. Customs Service is currently initiating such a formal long-range planning system.

I will now ask Robert Chasen, Commissioner of Customs, to provide you with a more detailed discussion of the apprcpriations request and we will then be happy to respond to questions you may have.

OPENING REMARKS OF MR. DAVIS

Mr. Davis. Thank you, Mr. Chairman, Senator Schmitt. In a way it is somehwat difficult to follow Mr. Schmitt's opening remarks with what I had prepared on the organizational structure of the Customs Service. But I just want to say briefly that we recognize, as I think the committee does, that the Customs Service has an incredibly diverse mission, a mission that forces it to constantly engage in a difficult balancing process.

The clearest example, which you referred to in your opening statement, relates to the processing of passengers and cargoes. The balancing on the one hand of the need to move people and products into this country in an expeditious manner and on the other hand to make certain at the same time that we are not allowing in contraband substances, particularly hard drugs, such as heroin. That requires the Service in many regards to make no one happy because it must balance the need for speed with the need for enforcement. We think that the program is in place and the Commissioner has taken the necessary steps to try and deal with that.

Also, Customs has an important interdiction responsibility and continues to make attempts at a very difficult job of trying to police this country's vast borders. We have interdicted a substantial amount of narcotics in the past year. That is not to suggest there is not a substantial amount of narcotics that breach the border. But as I am sure we will discuss during the course of the hearing, the problem must not be looked at as something that begins and ends with the Customs Service's responsibility at the border. This involves the difficult problems of dealing with source countries and the importance of follow-up investigations to try and crack smuggling rings in the United States.

Last, there has also been some reference to the question of the investigations that are now going on in New York. I think that the investigations in New York are a good thing. They are not a good thing because they are uncovering corruption in the Customs Service. They are a good thing because if there is corruption, we want to find it. The Customs Service has taken the bull by the horns, initiated this investigation, and is working very actively with the U.S. Attorney's Office.

While there is pain all must suffer during the course of these investigations, I think it is an essential kind of pain that in the long run is necessary for the Customs Service and other Government agencies to have confidence in their people. The Commissioner deserves a substantial amount of credit for his willingness to stand behind the investigators and behind that effort.

Finally, there is one matter that I would mention that may be of lesser magnitude in one sense, but, on the other hand, of importance because of the dollars and cents matters. That is the law in the Virgin Islands keeps changing back and forth about what we are supposed to pay and what we are not. We do not have in our 1981 budget request moneys to pay for the reimbursement to the Virgin Islands that would now be contemplated by legislation recently passed. Mr. Wilson, during the course of the testimony, can supply information on that.

PREPARED STATEMENT

Senator CHILES. Mr. Chasen, we would also hear your statement now. Your full statement will be put in the record.

[The statement follows:]

STATEMENT OF ROBERT E. CHASEN

INTRODUCTION

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before you today with my associates to present our FY 1981 appropriation request and the FY 1980 supplemental request. The latter request is for $22,153,000, which is required to offset the pay increase of October 1979.

In order to carry out the Customs mission during FY 1981, the Customs Service is requesting an appropriation of $465,700,000. This appropriation level represents an increase of $1.4 million over the proposed authorized level for FY 1980. The requested amount reflects the Administration's March 31, 1980, adjustments to the Budget.

The proposed authorized level for FY 1980 reflects an appropriation transfer of $5,271,000 to the International Trade Administration, Department of Commerce, for the Antidumping and Countervailing Duty Progra This transfer was authorized by Reorganization Plan Number 3. This FY 1981 Appropriation request does not include resources for the activity which was transferred.

In accordance with the desire for fiscal restraint, the proposed appropriation for FY 1981 reflects the minimum requirements for maintaining Customs effectiveness. This is especially significant in view of the increasing complexities involved in administering our responsibilities under Customs laws, and the laws of other agencies which we enforce.

Our basic role continues to be the facilitation of international trade and travel, and to enforce this nation's complex tariff laws and regulations. Firstly, as a primary revenue collection agency and enforcer of our Trade Laws, Customs administers U.S. tariff laws, regulations, agreements, quota administration and statistical programs. Without effective implementation of these laws, imports could adversely affect domestic industry and the U.S. economy. Secondly, Customs is necessarily oriented toward serving both consumers and business.

Travelers must be processed and inspected efficiently and courteously. The private business sector similarly depends on us to expedite the flow of materials and goods upon which U.S. industry depends. Lastly, but of equal importance, the Service is the country's major border defense against the flow of commercial quantities of narcotics and contraband.

The Customs Service continues to be a major source of revenue for the Federal Government, as well as a vitally important law enforcement arm. During FY 1979, Customs collected a record $8.5 billion in revenue, up $1 billion or 12 percent over FY 1978. This translates into a return of almost $20 to the U.S. Treasury for every dollar expended in carrying out our responsibilities at 300 ports of entry on our Nation's land, air and sea borders.

GENERAL STATEMENT

This budget does not propose increased resources for workload growth. However, we estimate that a total of 284 million persons will cross our borders by all modes of transportation. This is an increase of 15 million or 5.3 percent over FY 1979. Arrivals of individuals by air are expected to total 30 million, an increase of 24 percent over the level processed in FY 1979.

In FY 1981, the Customs Service should process approximately 4.7 million formal entries of merchandise, an increase of 316,000 or 10.2 percent over the level processed in FY 1979. In addition, revenues from cargo, mail, and baggage in FY 1981 have been estimated at $110 billion. This is $1.5 billion or 18 percent greater than the revenue collected in FY 1979.

We will handle this additional workload by increasing productivity throughout the Customs Service. We are approaching this objective in two ways. First, through the review of functions and subsequent reorganization of the National Headquarters, we have been able to redirect almost 200 positions to "on-the-line" activities. This review is now being broadened to cover Regional Headquarters Staffs.

In addition to reducing overhead and redirecting staffing, we are continuing approaches for increasing productivity through the adoption of innovative alternatives for processing workload. Presently we are expanding the use of the "Citizens By-Pass/One Stop" concept of inspection of individuals and evaluating the "Accelerated Cargo Clearance and Entry Processing Test (ACCEPT)" method for inspection and clearance of cargo.

Within a context of limited resources, Customs will refocus its efforts in several basic ways. The development of strategies, identification of priorities and emphasis and determination of criteria for expedient processing of passengers and cargo are already underway in our enforcement and interdiction programs. With the sheer volume of regulations and laws, we are arranging our priorities to achieve the greatest return from our resource investment. Application of technology, with greater emphasis on selectivity and increased cooperation with other agencies are other approaches being explored by Customs. Our workload will not decrease, and at the same time, we cannot continually request large increases in our budget. We must rely on new technology and data processing if we are to keep pace. Finally, internal management improvements and controls, including annual performance goals and increased efforts toward improved program measurement and evaluation systems, have been initiated to distribute available resources more effectively. With the help of Civil Service reform, I will continue to demand accountability in individual performance.

I have instituted a new reliance on objective setting as a management system. This represents to me a way to ascertain that each program's objectives are clear and our means to achieve them have been thoroughly analyzed. The Service is also developing an agency-wide consolidated plan to identify the major problems and opportunities that will face the Customs Service in the next five years and to institutionalize long-range planning so we can formulate plans, policies and objectives in conjunction with our resource levels. At the request of the Appropriation Committees the Customs Service has entered into a contract for a study to be developed on a long-range basis, looking toward the development of a modern, efficient, and cost effective Customs Service. The results of that study have been furnished to the committees.

Because of my personal interest and the public concern in the amount of overtime paid to government employees, an objective for the control and declining use of overtime has been directed to Customs Service Managers. This is one of the criteria by which I will measure management performance and accountability. As you know, the Congress has directed that a restriction of $20,000 is to be placed on the amount of overtime which a Customs employee may be paid during FY 1980. Systems have been implemented to monitor and to control earnings accordingly.

In placing this restriction on overtime, the Congress recognized that additional personnel would be required to assume the assignments which could not now be covered. The 200 additional inspectional positions which were provided essentially to reduce overtime have all been allocated. In addition, at the recommendation of the Appropriation Committees we have explored other methods of reducing excessive overtime in the Customs Service, and reported our findings in March 1980.

PROGRAM INCREASES

Customs recognizes the potential benefits to be gained from dealing with large importers as a total economic entity as opposed to attempting to deal with each of their individual entry transactions and is currently developing the necessary operational procedures to attain this objective. At the core of this approach is the Regulatory Audit program. Regulatory Audit was established within Customs to develop the necessary capability to verify importers' compliance with the various laws and regulations enforced by Customs through the use of audit procedures in lieu of the traditional and more costly physical controls and other current means of verification. The audit program has proven it is ideally suited to deal with the modern (multinational) business techniques utilized by the type of firms which fall into the top 5,000 importers. It will provide the necessary mechanism to verify the conduct of the major importers and thus provide the basis for placing them on a sound footing for conducting their Customs business. This, in turn, will permit Customs to more effectively and efficiently process its increasing workload. This budget requests an increase of $386,000 and 10 positions for this program.

The development of sophisticated enforcement systems continues to help offset the smuggler's natural advantage of selecting the time, mode and place for bringing contraband into the United States. Our objective is to support the enforcement officer with modern technology in the detection and interdiction of smuggling. In this regard we are requesting $750,000 to equip our turboprop aircraft with "Forward Looking Infrared (FLIR)". The turboprops are versatile aircraft from the standpoint of range, endurance, and economy of operation. However, they have no night-time detection, recognition, and identification capabilities. The FLIR is the only appropriate technology which provides these capabilities in a single system suitable for turboprop aircraft.

Ever since I became the Commissioner of Customs I have been concerned about the lack of a comprehensive Occupational Safety and Health Program within the Customs Service. Two years ago we contracted with a consultant to determine our compliance with the law and to identify our requirements. The consultant reported that the Customs Service is in compliance with only 23 percent of the requirement of the law. This is especially disturbing when you consider the number of Customs personnel who are continually exposed to such hazards as carbon monoxide, lead, noise, carcinogenic chemicals and other substances. This budget requests $525,000 and 12 positions to begin to implement corrective actions.

Another area related to the safety of Customs employees is the age and/or condition of vehicles within our motor vehicle fleet. Based upon present usage, in FY 1981 we will have over 500 vehicles which meet or exceed replacement standards. We plan to replace only 300 of these vehicles in FY 1981 and this budget requests an increase of $700,000 for our vehicle replacement program.

RECENT ACTIVITIES AND ACCOMPLISHMENTS

I have briefly touched on each of the program increases which are discussed in greater detail in our budget submission. To provide more information pertinent to our total budget request for FY 1981, I would like to provide a brief review of Customs accomplishments and what we expect to do in the coming year.

HEADQUARTERS REORGANIZATION

On August 1, 1979, the U.S. Customs Service began implementation of a major reorganization of our Headquarters offices. The genesis of this reorganization was executive management's concern that the Headquarters had grown considerably over the past several years in structure, scope and total staffing. Therefore, the three underlying goals of the reorganization were to establish a new organizational framework for the Headquarters, to stabilize the size of the Headquarters at reasonably reduced levels, and to achieve a more balanced emphasis on both the trade and enforcement components of the Service. In support of these goals, the reorganization's specific objectives are to streamline the Headquarters structure, to reduce duplication and fragmentation of functions and to concurrently centralize key planning, budget and evaluation programs.

To initiate the reorganization, a new organizational framework for the Headquarters was established on August 1, 1979, and every organizational entity was aligned under the new structure. Subsequent refinements of the reorganization will include identifying organizational entities which can be further consolidated, instituting controlled hiring practices and special placement procedures intended to redistribute Headquarters staffing and designating Headquarters organizations with distinct "operating" functions as Field organizations.

As a corollary to our Headquarters reorganization, management has directed the reallocation of almost 200 postions from the Headquarters to the Customs field structure.

INTERNATIONAL COOPERATION IN TRADE, TRAVEL AND NARCOTICS

In cooperation with other U.S. agencies, U.S. Customs pursues a dynamic program designed to facilitate international trade and travel. It is carried out principally through U.S. membership in the Customs Cooperation Council, an 88-member international organization with Headquarters in Brussels, as well as through other organizations. The Customs Cooperation Council is devoted to the promotion of international trade and travel through the simplification and standardization of international Customs procedures.

The Council is responsible for three new international conventions which will impact directly on U.S. international trade. It is responsible for the technical administration of the new international valuation code encompassed in the Trade Agreements Act of 1979, the development of a new international commodity description and coding system, and the International Convention of the Simplification and Harmonization of Customs Procedures. The successful completion of the Council's work should help in future trade negotiations by providing the framework for determining Customs duties in many countries and simplifying Customs procedures throughout the world by encouraging the reduction of formalities and paperwork.

At the bilateral level, U.S. Customs has been especially active in developing cooperative programs with Mexican Customs under the 1976 Mexican-American Customs Mutual Assistance Agreement. We have since the inception of the Agreement fully cooperated with Mexican officials in the investigation of all alleged Customs offenses. Our willingness to cooperate in this manner has contributed to the excellent relations which exist between our Customs Service and to our ability to play an active role in the joint Working Group on Legal Affairs under the U.S./Mexico Consultative Mechanism established by Presidents Carter and Portillo. Moreover, evidence obtained from the Mexican Government under the Agreement in 1978 and 1979 has been used in currency cases involving in excess of $50 million in U.S. currency and the indictment of more than 20 persons.

In addition, operating under the auspices of the Department of State's Bureau of International Narcotics Matters, the U.S. Customs Service provides a variety of enforcement training to foreign Customs officers. The training is designed to help developing nations, especially those known to produce, manufacture, and ship illegal drugs, improve the proficiency of their Customs officers and to assist their services in achieving self-sufficiency in enforcement training. In FY 1979, more than 500 foreign Customs officers attended the two-week Enforcement Course conducted in ten different countries. This training focused upon narcotics identification, border surveillance, cargo security, passenger control, and search and seizure techniques. Other training programs, conducted within the United States, included Executive Observation Courses and Mid-Management Seminars. Over 50 mid-level officers attended the seminars, representing regions of intense narcotics activity. In addition, U.S. Customs trained 49 officers from eight nations in its three-week dog training and 14-week detector dog handler courses at Front Royal, Virginia.

INSPECTION AND CONTROL

Perhaps the most visible aspect of the Customs Service is its responsibility for inspection and control. Last year we processed over $200 billion worth of imported merchandise, and cleared more than 269 million persons and some 82 million cars, trucks and buses. The number of travelers and tons of cargo going through Customs has increased about seven percent annually for the past several years. Accordingly, Customs continues to examine its procedures to increase efficiency and effectiveness.

New Inspection Techniques

The most recent major inspection improvement has been the advent of the one-stop inspection system for air passengers. This system, developed jointly by Customs and Immigration, results in the more efficient use of facilities and inspectors as both the Customs and Immigration inspections are performed by one Federal inspector at one location. The Treasury Enforcement Communications System (TECS) continues to be a key technological tool contributing to the success of this inspection system by providing access to both Customs and INS enforcement lookout information. Tests of the system at Philadelphia International Airport in FY 1979 showed facilitation increases of up to 29 percent. These increases occured without Customs or Immigration staffing increases despite a 7 percent passenger increase.

Because most airport facilities do not have sufficient queuing space to accommodate all passengers in one inspection area, one-stop is being implemented only at new facilities designed for one-stop or at airports undergoing major renovation. One-stop is currently operational at Philadelphia and at the Edmonton, Canada, preclearance station. By the end of FY 1980, we expect to have the one-stop system operational at the Los Angeles, Houston, Atlanta, Albuquerque, and San Antonio airports. Plans are being drawn to install one-stop in the Orlando, Tucson and Dallas/Ft. Worth airports and the Winnipeg, Canada, preclearance station during FY 1981.

Specialized plans are being developed to facilitate the processing of land border crossers. By modifying several computerized queuing models that analyze inspection rates, vehicle arrival patterns and inspection operational data, we have been successful in this effort. This program is also useful in determining the need for revised staffing or processing guidelines. Inappropriate lane capacity, approach roads and staffing limitations preclude the use of this technique at all land border ports; but where possible, this approach will be implemented.

We hope that innovative uses of the physical and chemical sciences will provide new tools to detect concealed narcotics and other contraband without impeding the movement of people and goods into the country. With this as an objective and to assist our inspectors, Customs is moving forward in the development and evaluation of techniques for rapidly examinig cargo containers, general aviation and commercial aircraft, vehicles, parcels and letter mail.

Accelerated Cargo Clearance and Entry Processing Test (ACCEPT)

ACCEPT is being tried out at selected ports. Its purpose is to permit inspectors and import specialists to give more attention to high-risk, high-value shipments. ACCEPT is designed to make it easier to enter and clear imported cargo, improve service to the public, and use available manpower more effectively.

Inspectors and import specialists determine the criteria for high-risk goods and importers. Low-risk entries need not be individually examined. However, they are examined on a random sample basis. This is done to check the validity of the criteria, maintain the integrity of the program, evaluate the system, and guard against revenue loss. A thorough evaluation of this program will be conducted prior to national implementation.

Oil Imports and Gauging

The U.S. Customs Service is responsible for monitoring and controlling importations of petroleum and petroleum products into the United States. It is our policy that we will ensure accurate and reliable statistical reporting of these imports and that proper controls will be maintained. A survey in July 1979 was conducted which found that although Customs maintained proper control of oil imports, it was lacking standardized procedures. In order to strengthen our control and improve our monitoring capability, standard procedures have been developed and will be implemented during early 1980. These changes will be disseminated to field personnel and a new training course and training manual for petroleum gauging will be instituted. The Customs Service clearly understands its role as an independent reporting and monitoring agency in this vital area that is of critical concern to the country.

New Miami Airport Facility

The new terminal at Miami International Airport is scheduled to open in Mid-April although only 60 percent of the Customs inspection lanes will be operational at that time. By the end of FY 1980, however, all construction will be completed. The new facility will have a higher processing capacity than does the existing terminal and fifty new inspector positions were recently allocated to the Miami airport to facilitate passenger inspection when the facility opens.

Passenger arrivals increased 21 percent at Miami during FY 1979, exceeding three million for the first time. Should workload increases of this magnitude continue during FY 1980, it will place pressure on on us to efficiently process the workload with existing resources.

Edmonton Preclearance

The interim preclearance facility at Edmonton opened on October 28, 1979, with a Customs complement of 8 inspectors and 1 supervisor. The larger permanent facility is scheduled for completion in July 1981. The expected passenger volume for the first year of operation is anticipated to be approximately 225,000 passengers. Due to the intense petroleum development activity scheduled for the next 5 to 10 years in the Edmonton area, it is conservatively estimated that when the permanent facility opens it will be handling an additional 75,000 people, a 33 percent increase.

New Dallas/Fort Worth Facilities

Dallas/Ft. Worth International Airport currently has split Federal inspection facilities at both Braniff International and American Airline terminals. We have been largely unsuccessful in obtaining a commitment to construct one central international arrivals building. In fact, both Braniff and American Airlines are planning to build new and separate inspection facilities to be completed by the end of FY 1981. Because such separate facilities result in separate inspectional forces, optimum manpower utilization cannot be achieved. However both new terminals will incorporate the new one-stop inspection system, resulting in a more efficient use of staffing than currently exists. The one-stop implementation will mean that fewer additional inspector positions will be necessary to keep abreast of annual passenger arrival increases averaging 29 percent.

TARIFF AND TRADE

The ever increasing gap between Customs cargo and related entry documentation processing workload and available Customs resources represents one of the greatest problems Customs has to deal with. At its current growth rate, the workload in this area will double within the next 12 years. Recent budget experiences, on the other hand, clearly indicate resources will not correspondingly increase. Customs therefore, must resolve the workload/resource erosion problem by developing new workload analysis techniques, and utilize the results in developing innovative operational procedures and manpower allocation systems.

Traditionally, Customs has quantified its workload in terms of individual entries filed each fiscal year. Instead of quantifying the workload in terms of millions of individual entries processed, Customs is currently developing techniques to stratify the workload on an importer oriented basis. The initial results are impressive. Approximately 5,000 importers account for 51 percent of the total cargo and related entry documentation processing workload. Should we be able to place the importers in this category on a sound basis for conducting their Customs business, the resulting benefits to both the importers and Customs would be substantial.

Automation of Commercial Activities

In 1981, we intend to expand Automated Manifest Clearance Processing to four to six major airports around the country, and Automated Broker Interface Processing of Customs entries to participating brokers making entry at the eight Customs ports that currently have automated entry processing systems.

These efforts will be follow-ons to this years implementation of a nationwide Automated Collection Processing System, employing a national data communications network, and the successful pilot testing of the Automated Manifest Clearance System at Los Angeles airport and the Automated Broker Interface System at Baltimore, both of which are currently underway and have direct industry participation.

Customs Compliance Measurement Program

The Customs Compliance Measurement Program (CCMP) was designed to identify those areas in air passenger and cargo processing functions where cost-effective trade-offs between compliance and enforement and investment of resources can be realistically made. The first stage of CCMP-Cargo will consist of a single-port test in Philadelphia. This test will begin in July 1980 and run for at least six months. After approximately four months of statistical data analysis, Customs management will decide whether the results warrant proceeding to Stage II, a multi-port test.

The Phase I implementation of CCMP-Air Passenger will consist of a multi-port test in seven airports. The test will begin in Spring 1980 and run for at least one full year. Using a random sample, approximately 100,000 air passengers will be selected for intensive secondary examination during the course of the test.

TACTICAL INTERDICTION

The U.S. Customs Service has traditionally attempted to identify and control major smuggling routes: ports of entry, the land area between the port, and the illegal intrusions of private aircraft and small vessels. The pressures to expedite processing of incoming cargo and passengers place several constraints on our enforcement activities. To operate effectively within these constraints, we have developed increasingly selective enforcement systems which allow us to shift available enforcement resources to meet changes in the smuggling threat.

During the year Customs directed its efforts to improving the effectiveness of its border interdiction program. This year the primary emphasis of the program has been the Southeast border where massive amounts of drugs are entering the country and large flows of currency enter and leave each day to finance this international drug trafficking.

A significant initial step towards achieving an effective border interdiction has been the improved cooperation among the Federal agencies involved in drug enforcement. Customs, Coast Guard, Drug Enforcement Administration, and Immigration and Naturalization Service officials at all levels meet frequently to assure operational cooperation. Moreover, a series of joint interdiction operations have been undertaken at several border areas as well as airports. Participation of all agencies in developing and disseminating both strategic and tactical information on drug smuggling has produced significant results, particularly along the Southeast border.

As part of its efforts, Customs strengthened its interdiction effectiveness along the Florida/Gulf and Atlantic coasts. Early in the year, Customs bolstered its enforcement capability by transferring additional vessels, aircraft, and patrol officers and inspectors to the area. Patrol stations were opened at Key West, Fort Myer and Carrabelle, Florida; Brunswick, Georgia; Abbeville, Louisiana; and other locations along the New Jersey, Maryland, Delaware, and Virginia coasts. Augmenting these forces is the new full-fledged air unit at Jacksonville, Florida. Customs now has the capability for interdicting smuggling flights attempting to penetrate our borders in Northern Florida, Georgia, and the Carolinas.

In addition, Customs has upgraded its air interdiction capabilities by developing more modern aircraft. Most notable is the recent operational deployment of a second, fully sensored, high performance Cessna Four fast turboprop aircraft also have been added to the fleet for the vital apprehensive role. Finally, Customs deployed four T-39 (Sabreliner) jet aircraft on loan from the U.S. Air Force Airborne Warning and Control System (AWACS) or other long-range Air Force and FAA radars.

Using this improved capability, Customs mounted a special operation (Boomer/Falcon) during October 1979 with support from DEA, to counter the rapidly growing problem of smuggler aircraft from Columbia and the Caribbean Islands. In recent years enormous quantities of drugs have entered Florida for transshipment to other locations nationwide. In support of the operation, aircraft and pilots were transferred from the West Coast and Southwest border. Radar detection capability also was augmented by expanding the regular network. The operation was a success in one month Customs seized 785.6 pounds of cocaine, 1,203 pounds of Quaaludes, and 27 aircraft. The operation confirmed the interdiction capabilities of Customs recently acquired Cessna Citation, and the benefits of a well coordinated interagency attack on drug smuggling.

INVESTIGATIONS

In the past we have pursued a great number of low priority investigative cases and a large number of cases which result in no violations. Recognizing this short fall, the Customs Service is implementing an investigative strategy which stresses the quality and impact of enforcement actions over the quantity of cases. With this change in emphasis, this budget request proposes a reduction in this activity of $1.9 million and 57 positions. Over the next two years we expect to focus our investigative efforts on major white collar crime violations, organized crime, felony currency conspiracy violations, neutrality violations, commercial quantity smuggling and prohibited imports and significant fraud cases.

Currency and Foreign Transactions Reporting Act

The Customs Service has launched a major investigative effort emphasizing enforcement of the Currency and Foreign Transactions Reporting Act, a statute requiring financial institutions and individuals to report certain international currency transactions. Customs has a key role in the enforcement of the Act and in the maintenance and analysis of sensitive financial data. This currency enforcement effort operates through a Reports Analysis Unit, which is producing a central file of financial data obtained under the reporting requirements. Once the data is compiled, it is analyzed to identify possible violations and, when appropriate, transmit reports and information to other Federal law enforcement agencies. The agressive enforcement of the Act should provide the Federal law enforcement community with a unique and powerful tool to disrupt the operating capital of criminal elements using foreign financial havens and secret bank accounts to shelter their illicit cash proceeds -- criminal elements engaged in narcotics trafficking, securities fraud, labor racketeering, commercial fraud, organized crime, illegal gambling, and on and on. TECS lends automated support as an effective investigative tool to this Currency program.

In cooperation with the tactical interdiction program, a major case involving a transfer of $3.2 million from California to Miami of apparent drug trafficking proceeds was uncovered recently. During the year, this program has accounted for some $20 million in illegal currency transactions. Customs Special Agents have also been working much more closely with the Drug Enforcement Administration (DEA) over the past year in the development of major currency investigations linked to narcotics traffickers. There is solid evidence that enormous sums of money required to finance international drug traffickers are passing through financial institutions, particularly in the Florida area, and are being transported into and out of the U.S. without being properly reported. DEA, for example, has estimated that upwards of $35 billion in currency transactions each year are linked to drug smuggling. Customs' unique position in the enforcement of the Currency and Foreign Transactions Reporting Act (PL 91-508) is expected to play an increasing role in the Administration's drive against major traffickers. If we can successfully disrupt the illicit flow of currency into and out of this country, we can cut the "life blood" of these criminals permanently and cost effectively.

Investigations Support of Other Agencies

As in prior election years, Customs Special Agents have assisted the Secret Service in protecting candidates in the 1980 Presidential Campaign. Customs has identified 225 Special Agents throughout the Country who the Secret Service may call upon. This assistance will continue into the first quarter of FY 1981.

Also, as you know, the President's Council on Environmental Quality has assigned a top priority to the protection of endangered wildlife species -- particularly focusing on the smuggling of endangered animals, birds, furs, and animal skins into this country. During FY 1979, Customs Special Agents began taking a more aggressive role in breaking up major smuggling in endangered wildlife. These traffickers are large, well financed and highly organized dealing in millions of dollars, and may be linked to organized crime elements. This increased role has involved our Agency in greater exchange and cooperation with Federal and State law enforcement officials.

Cooperation With Other Agencies

The U.S. Customs Service has actively pursued a policy of cooperation and coordination with other federal agencies most responsible for joint activities at ports of entry. The various joint cooperative ventures range from those matters dealing primarily with the expeditious handling and entry of goods, persons, and carriers to program designed to improve enforcement. Most notable of the joint interagency cooperation efforts are the numerous agreements signed by the agency heads at monthly meetings between Customs, INS and APHIS over the past years. These agreements have resulted in major changes improving the processing of air passengers entering the U.S. and the sharing of resources. On the enforcement side, Customs has signed several interagency agreements with the Drug Enforcement Administration designed to improve drug interdiction at ports of entry. We have also worked closely with agencies such as State Department, Passport Services, and CIA which is improving the knowledge of Customs personnel in the detection of fraudulent documents and preparing for the possibility of terrorist attacks at port of entry.

In addition to enforcing the laws of other agencies we also cooperate through the exchange of technical advice and assistance. In FY 1979, Customs was able to support the Department of Defense with our own technical assistance. For example, we helped the Air Force by making several test flights in our Cessna Citation, which is equipped with one of the newest Air Force interceptor radars, to enable the Air Force to resolve problems they were having with this radar installed in their own aircraft; we also helped the Marine Corps by lending them one of our new infrared detection sets, to be used immediately in one of their development programs in lieu of the new system scheduled for their use later this year. In addition, we are providing to other government enforcement agencies, such as the FBI and DEA, technical guidance and equipment information based on our extensive experience in specific technological applications.

MANAGEMENT INTEGRITY

In April, 1979, the Office of Management Integrity was formed to provide the Customs Service with a fact-finding organization which would report to the Commissioner and assure that the highest possible standards of integrity are maintained, resources are prudently expended, and operational programs are being carried out in a productive and cost beneficial manner.

In 1981, emphasis will be on national audits in order to provide management with an overview of Customs programs to assure that efforts are being carried out in an efficient, effective and economical manner. Added efforts will be directed to inspecting and investigating areas where there is a suspicion of the misuse of Government funds or equipment. There will also be an increased emphasis placed upon physical security in the areas of Government and personal property, employee identification and electronic security.

VIRGIN ISLANDS COST

The question of how the cost for the Customs operations in the Virgin Islands is to be paid has been bounced back and forth several times in the last two years. Prior to Public Law 95-348 dated August 18, 1978, these costs were paid from Customs collections in the Virgin Islands. Public Law 95-348 provided that these costs would not be withheld from he collections. However, Public Law 96-38 dated July 25, 1979, ppropriating supplemental funds for Customs for fiscal year 1979 provided hat after September 30, 1978, Customs duties collected in the Virgin slands would be available to cover the cost of operation there. Finally n March 12, 1980, Public Law 96-205 provided that Customs receipts n the Virgin Islands would be used only to cover the cost of collections ttributable to the importation of petroleum products. Since this Bill was ust recently passed, none of the additional costs associated with it were onsidered in the preparation of our fiscal 1981 budget.

CONCLUSION

The Customs Service is one of the major revenue-producing and law forcement arms of our government. Customs provides substantial sums money for the government's operation at a very low cost, in addition providing essential enforcement support to national policies concerning ternational trade, national health, safety and security.

We fully support the efforts and interests of the Administration and is Committee to keep government expenditures to a minimum. Therefore, r program request represents our shared concern for fiscal restraint.

At this time, Mr. Chairman, I would like to place in the record formal opening statement and the standard table which outlines the ential components of our 1981 estimates.

This concludes my introductory remarks.

THE DEPARTMENT OF THE TREASURY
U.S. CUSTOMS SERVICE

Summary of Increases Requested for Fiscal Year 1981
(Dollars in thousands)

	Positions		Amount Increases/ Decreases	
	Total	Average		Total
Proposed authorized level for 1980	13,915	13,643		464,339
Program Changes				
1. Regulatory Audit	10	8	386	
2. Mini-FLIR	--	--	750	
3. Safety and Health	12	9	525	
4. Vehicles	--	--	700	
Total Program Changes	22	17		2,361
Other Changes				
Increases necessary to maintain current levels:				
1. Net cost of within-grade salary increases required by statute....			1,284	
2. Grade-to-grade promotions based on CSC performance standards for trainee-to-journeyman positions...			706	
3. Increase in payment to Employee Compensation Fund..................			483	
4. To provide for full-year cost of program increases authorized for a part of FY 1980................	--	29	589	
5. Increase in FTS and other telecommunication costs.			767	
6. Support services and facilities..............			500	
7. SES awards..............			352	

THE DEPARTMENT OF THE TREASURY
U.S. CUSTOMS SERVICE

Summary of Increases Requested for Fiscal Year 1981
(Dollars in thousands)

	Positions		Amount Increases/ Decreases	Total
	Total	Average		
Other Changes (Continued)				
8. Increased cost of replacement vehicles..			328	
9. Increased rates for health benefits..............			519	
10. Increases in printing cost...................			125	
11. Increase in postal costs.................			125	
12. Adjustment for absorption of a portion of pay increase in FY 1980...........	--		2,120	
Subtotal, Increases maintain Current Levels	--	29		$ 7,898
Reductions, Nonrecurring costs and savings:				
1. Reduction in inspection and control.........	-9	-22	-1,538	
2. Reduction in investigations	-57	-56	-1,899	
3. Transfer to Department of Commerce for antidumping and countervailing duty program	--	-32	-1,000	
4. Reduction in travel..			- 550	
5. Transfer to State Department..........			- 130	
6. One less work day in FY 1981..............			-1,092	
7. Nonrecurring.........			-1,439	
8. Reduction in tactical interdiction.........	-30	-30	- 750	
9. Reduction in tariff and trade............	-20	-20	- 500	8,898
Total, Other Changes	-116	-131		-1,000
Net Increase/Decrease	-94	-114		1,361
FY 1981 Appropriation Estimates	13,321	13,529		465,700

OPENING REMARKS OF MR. CHASEN

Mr. CHASEN. Mr. Chairman, and Senator Schmitt, I appreciate the opportunity to be here today, together with my colleague, Deputy Commissioner Bill Archey, and Budget Officer Ken Wilson. We also have Mr. Kallen here from the Treasury Department.

In order to carry out our mission, we are requesting a budget of $465 million and we also request consideration of our fiscal year 1980 supplemental request for $22,153,000 which is required to offset the pay increase of October 1979.

As you know, Customs is a major source of revenue for the Government. We collected $8.5 billion in 1979 or a return of almost $20 for each dollar expended in carrying out our responsibilities. In the business world, I would say that this is a pretty good return on investment. Also, I would say that to continue this type of successful operation you have to plan, monitor and control, and that is what we have been trying to do in Customs.

We have an advanced planning department which tells us that today $200 billion imports will be coming this year through Customs. But in 1986, that will rise to $537 billion. The $8.5 billion of collection that we talked about will rise to almost $17 billion in 1986. Arriving international passengers in 1986 will approximate 300 million.

With this insight into the future, the management team we now have in place at Customs is installing institutional methods and programs and disciplines through modern and scientific business techniques so that tomorrow's problems come as no surprise and can be solved by intelligent processes.

We are also concentrating on enforcement, and we have molded our inspectors, investigators, and Customs patrol officers together into one unified law enforcement group. Our main thrust is against the smuggling of narcotics at the border, but it does include frauds and white collar violators.

We have paid particular attention—and I welcome the chance to discuss with Senator Schmitt his allegations about our air arm because we have developed a new modular program which we have already experimentally tested in Florida and which will again be evaluated within the near future on a more formal basis.

Our overall program is to combine integrity, accountability, and scientific management into one philosophy of efficiency and service to the public.

Thank you very much.

Senator CHILES. Thank you, gentlemen.

BOOMER FALCON I VS. BOOMER FALCON II

Last fall the U.S. Customs Service, the Coast Guard, DEA, and the FAA participated in an experimental drug interdiction program called Boomer Falcon I. The purpose of that program was to interdict the flow of drugs from South America into Florida. The program was highly successful and there were record amounts of cocaine seized.

I understand the program was repeated this year and terminated last month. It is also my understanding that Boomer Falcon II was less successful. While there was some marihuana seized, there was very little cocaine seized.

We have heard rumors that the more sophisticated crime families that trade in cocaine seemed to have some advance information regarding Boomer Falcon II.

How would you assess the difference between Boomer Falcon I and Boomer Falcon II? Do you have any evidence that there were security leaks with Boomer Falcon II?

Mr. CHASEN. Boomer Falcon I was an extremely successful program and because it was so successful it probably impacted the probability of success in Boomer Falcon II. We did have the two largest cocaine hits I believe in the history of Customs as part of Boomer Falcon I.

In planning Boomer Falcon II, we recognized the fact that our activities had been well publicized and that the smugglers might get advance information. We tried to build into Boomer Falcon II techniques that would provide us with information concerning displacement; if the smugglers knew of Boomer Falcon II and they would elect other areas in which to offload the narcotics, where might that be.

We are still collecting data on that, but it would appear from our intelligence sources and from what we have learned about displacement that the smugglers did know enough about Boomer Falcon II to either hold up their activities or to assign other locations outside the southeast area, mainly Florida. We are just going to have to plan the operation much more secretly and use some kind of deception because we do have leaks of some kind which have provided information to the smugglers. We do conclude that from Boomer Falcon II, that there must have been some leaks.

SMUGGLERS REACTION TO AID INTERDICTION

Senator CHILES. My understanding is that you don't think there was displacement, that they simply laid low during the period of time. Is that correct?

Mr. CHASEN. It could be both, sir. We believe there was displacement and we believe also that they withheld shipments. I think it is a little too early to tell for sure what percentage of which was present.

Senator CHILES. I know that we are talking about sensitive things here, and I don't want to do anything that would in any way compromise any future actions that you are going into. Obviously Boomer Falcon I is well known by the traffickers, and certainly II, so we are not dealing with any secrets. They know about it. Maybe the people should know more about it, that there are attempts to try to deal with it.

I wonder, if you had a period of 17 or 18 days in which you had all of the smugglers laying low in cocaine, or virtually laying low because they think you are out there, how can we get that kind of feeling going all the time? In other words, if they think the traffic cop is on the beat or the patrol car is out there and they are going to be caught and they start laying low, why can't we have them think that all the time? I would be a lot more comforted and the State of Florida would be a lot more comforted if they were going somewhere else or if they did know that they could not come into Florida. I think the United States would feel more comfortable, too, if we could have that kind of feeling.

So what kind of resources are we talking about to have this kind of coverage or the feeling that this coverage could be out there at any time to influence their operations?

Mr. CHASEN. Boomer Falcon I and II were extremely valuable experiments. Incidentally, Boomer Falcon II was of shorter duration than Boomer Falcon I. When you compare results, one has to take that into consideration.

But as a result of the Boomer Falcon operations, we have had confirmed the plans we have for a new air program. Bill, do you want to talk about this program? Because I think really what we are saying, Senator, is we agree that these were so successful that some kind of a permanent operation is justified. We think it will work. That is what we are talking about.

Senator CHILES. Mr. Archey?

Mr. ARCHEY. Senator, by the end of this week we are going to have from our regional office in Florida a plan for making permanent some aspects of the Boomer Falcons. Obviously, as you just suggested, I would rather not get into the details of what that consists of. But we feel that some of the aspects we learned in both of those exercises warrant making a part of that a permanent aspect of our operation and our dealing especially with DEA.

AIR INTERDICTION MODULE TEST

Second, sometime early summer we are going to be doing a 6-month test of an air program interdiction module. The committee has received a copy of the air program study. We are going to be able to test that module without additional acquisition of aircraft. Our newest one is coming online May 31 to Miami. We are going to be testing for a full 6 months with a very tightly designed plan and evaluation plan basically the interdiction strategy proposed in the air program. We are going to be setting out very specific objectives, and we are going to be looking for what kind of results may accrue from this to then give us a lot more informed view regarding whether or not future modules along the lines proposed in the study ought to be sought after.

We don't want to do that until we really have a good feel. We think 6 months will give us an opportunity to look at displacement. It will give us an opportunity to really have a fix. Also we think we will minimize the halo effect problems we have had. So we are planning to do some things very quickly.

Senator CHILES. Well, does that mean that it is going to be about 1 year basically before we can have any followup?

Mr. ARCHEY. Some of the things we have done in Boomer Falcon II we may be able to go with almost immediately. We are waiting to see what the basic proposals are.

Those will not be high-cost ones, either. We are basically talking about the second shift. But as far as the air program, we are going to begin that within about 3 months along the lines and according to the schedule that is proposed in the air study. It is exactly on line and on schedule.

Mr. CHASEN. I might add, Senator, to fully implement this program, there are some capital acquisitions involved which would involve a time lag to make the acquisition. So the way the program is phased out, it will be a continuing program, but we would have to wait for the delivery of some of the equipment that is in the plan.

But not for the test we are talking about. That will be done out of the equipment we have.

Senator CHILES. My concern is when you say we are going to have a 6-month evaluation to run the tests on the program, we are looking at a considerable amount of time before we can get an expanded program funded and operational.

Mr. ARCHEY. We are talking about a concurrent evaluation of the program as it is going on. It will be on a lapsed period of time of 6 months, which we don't think, given the fact there is an awful lot we need to learn—and where we are actually putting in a concentrated air program and modules together, we need to really find out if this is the way to go. We feel that you have to have a period of time.

The time span of the Boomer Falcons is not enough time to validly test it because of some of the problems we already discussed. We just don't think people can lay low for 6 months. That is one of the reasons we want to have an extended period of time. We don't think 6 months is really far out in terms of what is riding on this test and the type of evaluation results which may indeed direct how the Customs Service deals with this problem and program for years to come.

ECONOMIC EFFECT OF ILLEGAL FUNDS

Senator CHILES. We are estimating in 1978 that we had about $7 billion of illegal moneys in the State of Florida from cocaine and marihuana. That is 1978. We don't seem to have the 1979 figures yet.

That is distorting our economy so much down there that we find the drug dealer is the biggest buyer of property, the biggest buyer of businesses, and no tax dollars are paid on any of that. We had an economist telling us that a house in Miami has $2,000 added to the purchase price simply from the inflation caused by narcotics dollars.

So when you start talking about time periods, they are very critical in that kind of situation. The narco-dollar brings corruption with it, it brings killings that we have on the streets down there every day, with the cocaine cowboys.

Mr. DAVIS. Senator, that is not to suggest nothing goes on in the next 6 months or year in Customs with air interdiction. There are many other programs trying to deal with problems in Florida as well as elsewhere. We are focusing on the money, as you referred to earlier, with intensified investigations of currency flow to find who may be illegally moving currency or violating the Bank Secrecy Act. Also, we are working with DEA in Florida to deal with the so-called cocaine cowboys and the use of illegal weapons. As you can see, there are a number of fully operational programs.

Senator SCHMITT. Mr. Chairman, would you yield on this point?

Senator CHILES. Yes.

ORGANIZATIONAL STRUCTURE OF AIR PROGRAM

Senator SCHMITT. Mr. Chairman, the report that this committee instructed the Customs Service to prepare on the air interdiction program, which is a major part of what we are talking about and about which the chairman is concerned, with respect to Florida, included in its executive summary the following statement: "Based on the estimated number of air smuggling intrusions as presented in the recently published Stanford Assessment, the number of air smugglers currently being apprehended by Customs appears to be very small. Specifically, air interdiction results can be equated to 1 percent of the estimated 6,700 intrusions or 6 percent of the estimated 1,000 aircraft used in smuggling."

Now in every draft of the report that this Senator saw, there was addressed in great detail the problems with the regional commissioner structure for the air program. It seems as if the people preparing the report felt that the air interdiction program was unworkable and contributed to this very low success rate. Why were the references to these particular problems left out of the final report?

Mr. ARCHEY. I am not aware of any conscious effort to leave that out of the report. I think one of the issues——

Senator SCHMITT. Why was there an unconscious effort then?

Mr. ARCHEY. I think, for example, Senator, in Miami, where the regional commissioner is taking a very active involvement in the air program and where we have the largest concentration of aircraft and support resources, that among the patrol people and certainly senior management of the Customs Service we feel the regional commissioner in Miami is doing an excellent job in managing and bringing about some discipline and some rather effective results with the Miami air program.

I think the concern we have is that what we really are trying to do right now is to say what are the policies, the operational procedures, the reporting procedures, et cetera, on a guide-year basis.

CENTRALIZED CONTROL OF THE AIR INTERDICTION PROGRAM

Senator SCHMITT. You are not answering my question. The people working on the problem—and these were people from within the organization who have dedicated their very lives to this effort—felt that the lack of coordination between the regional commissioners and the basic structure under which those commissioners worked, the basic budgetary discipline with which they use the moneys allocated to the air interdiction program, was unworkable, that that was a central problem. Yet this report doesn't address that problem.

It is a good report, but it doesn't address that fundamental problem. It relates to what this committee was concerned about, and that is the question of centralized control.

Should there be centralized control of the air interdiction program? You don't address that problem.

Mr. DAVIS. Senator, I am not sure what earlier drafts you are referring to, however, the cover letter to the report does focus on the centralization issue and the role of the regional commissioners.

I think the suggestion that headquarters plainly has to play and does play a major role in preventing the overpossessiveness by regional commissioners of "their" airplanes is sound. This is done by controlling the movement of planes from headquarters. In the past year, Customs has increased its control in headquarters. Also, there are other areas of authority that exist in headquarters.

I agree that the question of whether the entire program should be centralized—that is, whether the line authority should run from the patrol director in terms of the management of each of the individual operations—was not covered conclusively in the report submitted to you. My understanding is this issue would be focused on depending on how the test works.

Senator SCHMITT. We are going to study this thing to death while this very low success rate continues. It is my understanding, for example, that any combined operation between two regions, no matter how small, can't take place—that there is no centralized activity unless it goes through the bureaucratic maze here in Washington; whereas, the centralized operational command for all of the regions, for the total air interdiction program, would not only alleviate that problem but would make for better cooperation with DEA and other agencies.

It is my understanding Boomer Falcon II had a heck of a time getting off the ground because everybody was ready but Customs.

Mr. DAVIS. The bureaucratic maze in Washington would be really the same whether or not you have it centralized.

CENTRALIZED CONTROL OF THE AIR INTERDICTION PROGRAM

Senator SCHMITT. No; you don't know what I am talking about. Apparently, Mr. Davis, you don't know what a centralized command, control, and communications system is. The Air Force has used it forever. They know how to do it. Have you ever worked with the Air Force to try to set up a centralized command, control, and communications system?

Mr. DAVIS. I have never worked with the Air Force to set up a centralized command control and communications system. However, I have had experience in working with law enforcement agencies which have a variety of different command structures.

Senator SCHMITT. Such a centralized control program doesn't include independent fiefdoms at the regional level. It just doesn't include it. That is where I think we are running into problems. The chairman has rightly said, why can't we impose a fear of interdiction continuously on these traffickers. I think we can. We can't because they know that the internal structure of the air interdiction program isn't working. Unless you concentrate your planning along the planning of the Falcon programs, it isn't working.

I am not going to deny the success of the Boomer Falcons. I think it is a success. In fact, I think both of them were a success. They taught us a great deal about equipment, about what is possible to do. But unless we take the lessons from the Boomer Falcons and apply them and understand why they are not being applied on a day-to-day, week-to-week, continuous basis, we might as well not have run them for all they resulted in. Sure, you made a record bust, but it is a drop in the bucket compared to what is coming in on a daily basis.

Mr. DAVIS. I am sure the Commissioner and Deputy Commissioner want to amplify on some of the lessons of the Boomer Falcons. The key is not only Customs but also Customs working with other agencies.

I must say one of the issues which exists in law enforcement today is whenever you require the assistance of more than one agency, it is a herculean effort to get it moving forward. I think that is unfortunate, however, it is one of the things that exists unrelated to whether each agency has from your perspective a perfect command structure. One of the positive aspects of the Boomer Falcons was the herculean effort and we hope the results reinforce this kind of effort.

DEFICIENCY IN REGIONAL COMMAND STRUCTURE

Senator SCHMITT. But this effort overrode—it took a lot of time, but you finally overrode this deficiency in the regional command structure. It should have taught you that. Why is the Department and the Customs Service resisting a centralized air interdiction control and command system?

Mr. ARCHEY. First of all, I think on Boomer Falcon I and II we were able to transfer aircraft for that operation. I am not aware of any great resistance on the part of any of our regional field managers to those two programs. I think it did show we can move the aircraft.

The second thing I think is what you alluded to earlier about everybody was ready but Customs. I think the Commissioner and I both sat down with our planning headquarters people and the regional planning group in Miami because in fact there were several things that took place in Boomer Falcon I and II we thought would take place, specifically the Guantanamo radar and the fact of having some intelligence operations on the off island. Those were not in place at the time we were ready to go with II. We insisted they be in place.

It turned out there was no delay in the actual start time. But we wanted those to be in place because we wanted to see what the efficacy was especially of the Guantanamo radar and also the efficacy of the T-39.

The only other thing we wanted to know was the fact if we knew then there was the possibility of a security leak, we wanted to plan for there being displacement. If there was, we needed to have some analytical capability to deal with it. DEA assisted us by sending two people in, and we put two additional people on.

We think we will have some results from that analysis in the next week or two. But that was very important for us because we felt if there was a security leak, we would like to know what happened.

Senator SCHMITT. I think what you have done with these two exercises, and I compliment you for it, is prove the viability of centralized command control and communications, which you don't have on a day-to-day working basis. That is what I am trying to do. I am trying to say that is what the Boomer Falcons told us. If you can put together that kind of planning and centralized control on a day-to-day basis, you can have a tremendously greater impact with the proper equipment than you are having right now.

But on a day-to-day basis the regional commissioner structure has a terrible time with internat communications. Boomer Falcon was great. But on a day-to-day basis you can't tell me that is working. You don't have the communications system or the right kind of aircraft at the right place. The budgets are being diverted to other uses within the regional structure. It just isn't working. It is the most important part of the program.

CENTRALIZED POLICY AND OPERATION GUIDANCE

Mr. ARCHEY. Mr. Davis alluded to this in the cover letter. The first thing we are doing now is Mr. Asack, who is now the Director of the Air Program Headquarters, was brought in explicitly to deal with some of the issues you raised. One is we need to have better centralized policy guidance. We need more systematic operational plans. We need to have better equipment support and procurement activity regarding all of the programs because they are going seven different ways in terms of support activity.

All of those will be done, centralized in headquarters. What we are saying is, and I think this is a concern we have from a management point of view, I am not sure the problem is with the regional commissioners. I think sometimes there is in the Service a concern about the independent action of seven airbase commanders. I think there is a concern on our part of the trade-off of reporting directly to headquarters.

But the void right now, and we can see this void, is that there isn't enough policy and operational guidelines that guide the management in the day-to-day activity of the air base commanders.

I think we do already have centralized procurement. We do have centralized R. & D. We are testing some new radar presently, two different types. All of the procurement, the R. & D. specs, et cetera, came out of the centralized headquarters R. & D.

In the last few days, to get to the concern which you are rightly raising, we have delegated to the Director of Patrol at headquarters for any temporary assignment of an aircraft that the Director of Patrol at headquarters who has that delegated authority would be able to override any interest on the part of the regional commissioner.

I think that was a problem at one time. But I think the regional commissioners are understanding of the fact there will have to be changes and there will be different ways to do it.

We also have a new Director of Patrol who has just come aboard in the last 2 weeks. I think with his delegated authority, when an air base commander says, "We need something for a temporary assignment or special assignment for 1 week," or whatever, he will have the authority to move that plane.

Senator SCHMITT. I think in a hodge-podge way you are making headway. I would strongly recommend you sit with the Air Force and look at what a full command, control, and communications structure is. I notice it doesn't say procurement or any of these other things. It is command control and communication. If you haven't done that, just to satisfy me and maybe a few other Senators who are interested in this problem, very deeply, see if you can't organize a session with them to find out whether their type of control structure can be superimposed on the air interdiction program, because right now, frankly, based on all the evidence I have and the evidence you submitted in this report, it ain't working, it just ain't working commensurate with the problem.

AIRCRAFT UTILIZATION

Senator CHILES. I notice that the GAO report done for one of the House committees pointed out that of the 20 aircraft assigned to Customs' San Diego and Tucson air support activities, 8 were operational 80 percent of the time, 5 were operational 65 percent of the time, 2 were out of service 67 percent of the time, 3 were out of service 44 percent of the time, and in 2 cases there was no urgency to obtain parts because the aircraft were excess until other aircraft were transferred to Jacksonville, Fla. That is not a very good report on keeping your planes in service in my opinion.

What I want to know is, is it a question of money? You don't have enough money to maintain these planes? We want to do something about that.

Mr. ARCHEY. I think the operational program presently is costing us about $18 million a year presently, which is a substantial part of the budget. As you well know, as everyone knows, the fuel costs have added a great deal to the operation and is preventing certain other activities from being accomplished.

I think that one of the problems, Senator, that we had with the GAO study is that the utilization rate is not high enough. I think that if you compared Tucson it said about 3 percent. But that is a presumption of 24 hours a day and 7 days a week.

Our utilization figure, for example, in Miami, controlling for Boomer Falcon, just normal activity, was somewhere between 26 and 30 percent. But I would not be willing to defend the aircraft utilization figure. I think it is low. It is not as low as it looks because it does presume a 24-hour operation, which we do not have and clearly do not have the funds to provide.

One of the things, for example, we changed in Miami is there is a night shift which has become a standard shift which we didn't have before. That is probably something that is going to ensue if we go to some aspect of a permanent Boomer Falcon program.

AIR INTERDICTION MODULE

Senator CHILES. When you say modules, tell me what you are talking about in a module?

Mr. ARCHEY. We are talking about having an interdiction module that would consist of one mobile radar, TPS-1, one Beechcraft King Air with F-16 radar on it, another Beechcraft without the radar for pursuit, two Citations, each of which would be equipped with forward-looking radar, and one utility aircraft, and one other utility aircraft in reserve.

Senator SCHMITT. Is FLIR on any of those?

Mr. ARCHEY. Yes, sir.

What we would do on this, is the reason for this type of module, is we would have the capability, if one of the Citations were down, that we would have on standby——

Senator CHILES. How many aircraft in total would be in the module?

Mr. ARCHEY. Seven aircraft.

Senator CHILES. What is your cost of the module?

Mr. ARCHEY. The cost of the module, if we were to buy it new, the acquisition cost would be slightly in excess of $23 million, but that would also include mobile radar and some additional communications equipment for that module.

This module—and this is what we were talking about earlier—will be capable of being tested with the exception of one of the Beechcraft will not have the F–16 radar. But we can do everything else in testing this module with no additional acquisition costs. That is what we are talking about doing.

Senator CHILES. What kind of coverage would we get on the air routes into Florida from South America? Would it take more than a module to get coverage?

Mr. ARCHEY. That is something I would rather not talk about in this session.

Senator CHILES. All right. Fine.

CONTRACTS FOR REPORTS

Senator SCHMITT. Mr. Chairman, just for the record, I wonder if they could supply us with a list and the cost of reports you commissioned with outside sources in the last 2 years as to the Customs Service in general and the air interdiction program in particular. Would you do that?

Mr. DAVIS. Yes, sir.

[The information follows:]

REPORTS IN SUPPORT OF AIR INTERDICTION
FY 78-79-80

Document No.	Contractor	Award		Description
		Date	$	
Tc-78-4 (BOA)	Universal Sys.	5/3/78	$146,673	Design/Anal. to develop Aircraft Specs.
Interagency Support Agreement (Navy)	SRI Int'l.	8/21/78	$296,279	"Threat Assessment: Methodology and Analysis"
Tc-78-56 (BOA)	Hydrotronics	9/13/78	$104,990	Parts & Assemblies report in support of Cessna Citation
Tc-79-19	Universal Sys.	1/5/79	$ 83,300	High Performance Aircraft Prog. support and analysis in developing the aircraft
Tc-79-23	Professional Mgmt. Systems	1/12/79	$145,700	Recordkeeping/ Reporting Sys. for program mgr. & budget sub.
Tc-79-40	Advanced Log.	7/2/79	$ 34,260	Integrated Logis. Support for High Performance Aircraft
Tc-79-77	Georgia Tech.	10/17/79	$461,000	Development of Radar Analysis Mgmt. Program
*Tc-80-13	Peat, Marwick, Mitchell & Co.	11/30/79	$80,729	Long Range Plan Consolidated
Tc-80-18	Professional Mgmt. Sys. Inc.	1/9/80	$ 60,000	Aviation Operations Recordkeeping Reporting System (Phase III)

* Air Interdiction Program one of plans.

CUSTOMS SERVICES REPORTS IN GENERAL

Tc-78-13	The Diebold Group	1/25/78	$ 80,150	Assessment of ADP Management and Resources Utilization within the USCS
Tc-78-33	Cyril W. Donnelly	5/22/78	$ 14,000	Prepare 75-100 task analyses (same as CS-81184 below)
Tc-78-39	Cresap, McCormick & Paget	6/12/78	$ 55,657	USCS Headquarters Organization Study
CS-81852	Marius Farioletti	5/1/78	$ 5,400	Same as CS-81851 below
CS-81184	Cyril W. Donnelly	2/8/78	$ 9,000	Prepare 45-50 comprehensive task analyses by comparing individual tasks with position Classification Standards
CS-81851	Albert Sze	5/1/78	$ 9,000	Analyses of Customs Oper. and statistical reporting systems with a view towards development of a cargo Compliance Management Program
Tc-79-19	Universal Systems, Inc.	12/14/78	$83,300	HPA Program Analysis
Tc-79-40	Advanced Logis.	6/18/79	$32,137	ILS Plan for HPA Program
Tc-79-58	Assessment Design, Inc.	9/27/79	$17,874	Assessment Center Program
Tc-79-69	A.B. Andrews	9/27/79	$23,190	Develop Experimental Control
Tc-80-21	Middlesex Research Center	1/24/80	$24,800	Management Analysis Services

Tc-80-22	Albert Sze, Association	2/6/80	$15,120	*
Tc-80-27	Price Waterhouse & Co.	2/28/80	$45,000	Regional Study

* Development of Customs Compliance Measurement Program for FY 80 & 81

Tc-78-19	Alexander Grant	2/14/78	$20,000	Analysis of information on production costs for Japanese Steel and data pertaining to steel trigger

FAA VIOLATIONS

Senator SCHMITT. Mr. Chairman, if you yield just briefly, do you plan to suggest or submit legislative changes to match the recommendations made in the report to us? There are a number of legislative suggestions.

Mr. ARCHEY. We understand, Senator, that a number of those changes, particularly dealing with the FAA violations, that we are not sure that needs legislative changes. We have met with the FAA in the last 2 weeks. Our counsel offices have met to see whether or not the FAA authority could be delegated to the Customs Service.

I think that is the one thing—and I am glad you brought it up because, frankly, that was a bit of a surprise to us about how serious the fines and penalties can be for navigation violations. For example, purposely flying without lights is a $1,000 fine and up to 5 years in jail. Carrying gasoline in noncertified containers for purposes of extending the range is a violation. And systematic violations or repeat violations are subject to a prison sentence. The other one is tampering with tail numbers, which is 5 years.

But what we are trying to find out, Senator, is whether or not we have to go the statutory route or whether or not that could be delegated to a Customs officer.

Senator SCHMITT. How quickly do you think you will have an answer on each one? I think there must have been almost a dozen suggestions in there.

Mr. ARCHEY. I think on the FAA, whether or not it would have to be statutory, we would know sometime within the next couple of weeks.

Senator SCHMITT. Could we ask you to inform the committee as soon as possible about that?

Mr. ARCHEY. Yes, sir.

Senator SCHMITT. I was very impressed, and I think that probably the strongest point in the report is your discovery, if you will, or at least the systematic identification of these that can be done with simple law or administrative changes now.

Mr. DAVIS. We will be happy to supply that report once it describes the implementation steps and calendar for implementation and a variety of recommendations.

COMMUNICATION WITH AWACS FLIGHTS

Senator SCHMITT. You have a major communications problem in the use of training flights of the AWACS. What steps are being taken to fix that problem? It is my understanding in some cases even when a target is identified you can't get anybody to it because you can't communicate.

Mr. CHASEN. We have a man in charge of our air program who is Bob Asack. I am not aware of that being a problem. I was just double checking with Bob. If we could get Bob up here, he could explain that.

This is Bob Asack who is the head of the Air Support Division.

Mr. ASACK. Mr. Chairman, I am not aware that we have a severe problem in that area. We do have some coordination liaison problems based on a tentative schedule the Air Force put out which then may be cancelled rather abruptly.

The second problem we have is that some of the AWACS orbit areas are a significant distance from our bases. We do not have direct communications with them. We therefore go to an indirect means of communications and there are some slips.

Senator SCHMITT. So you think you are OK?

Mr. ASACK. Well, we are OK, except that the AWACS has not been as productive as we thought it would be. It looks now as if it may be more a collector of intelligence as to mass flow crossing the border than a tactical use of the aircraft.

AWACS CAPABILITY

Senator SCHMITT. That doesn't jibe with what AWACS is designed to do. I would think and hope you are trying to work out with the Air Force and with your own equipment some means of using it for what the AWACS is designed to do. The AWACS is not a mass flow statistical capability. It is a tactical capability. That is exactly what you need in order to better utilize your resources.

Mr. ASACK. I understand that, Senator, but we are a piggyback mission on the Air Force primary mission. We are assigned to training flights whose regular missions are not satisfactory to meet our needs. And, as a matter of fact, the detection coverage that we are afforded by those missions that are suitable doesn't raise our overall detection by more than 2 percent.

Now if we had the tactical use of that airplane, I would have to concur with you absolutely that we can in effect cut down smuggling wherever that aircraft is.

Senator SCHMITT. Have you seen anything that you feel the Air Force could do to raise the utilization rate of the AWACS and still not interfere with the training mission?

Mr. ASACK. There have been several requests in that area and we have had positive responses, but the recent international situation has disrupted that. There are fewer planes now available for training missions.

Senator SCHMITT. Has the case of the sabotaged Customs airplanes in Florida been solved yet?

Mr. ASACK. No, sir. It has been referred to the FBI.

REPROGRAMING OF $50,000 AT SAN ANTONIO AND EL PASO

Senator SCHMITT. It is my understanding, Mr. Davis, that there was recent reprograming activity which occurred in San Antonio and El Paso in which $50,000 was authorized by the national office to purchase special equipment for the King Air 200 but only $9,000 ended up being used for this purpose while the bulk of those funds were used to buy carpeting and plastic plants and other office equipment. Is this a true analysis of what happened? If not, could you supply now or for the record an answer?

Mr. DAVIS. I do not know. We would be happy to supply that for the record.

[The information follows:]

USE OF $50,000

On August 17, 1979, we provided the Houston region $48,000 for equipment and spare parts for the King Air aircraft. The document allocating these funds indicated they were for that purpose. At the time of this allocation the air program in the Houston region was operating at a deficit and headquarters had informed them we would provide additional funds. These funds were not provided until later in September. When Houston received the document allocating the $48,000 for the King Air aircraft their budget officer incorrectly applied part of the funds against the air program deficit. None of the $48,000 was used to purchase carpeting or plastic plants. Furniture and equipment items totaling $25,558 were purchased in the Houston region for the air program in September 1979 of which $20,168 was for the El Paso Air Branch. The following is a list of those items.

El Paso Branch:	
Defense Department handtools	$2,527
Battery charger	1,918
Hydraulic jacks	7,406
Trailer-mounted power unit	8,317
Total, El Paso	20,168
San Antonio Air Branch:	
4 calculators	519
1 typewriter	688
Aluminum carrying case	176
Total, San Antonio	1,383
Houston Air Branch:	
Binoculars	1,500
Powersaw	400
Air-conditioner	1,107
Desks and chairs	1,000
Total, Houston	4,007
Grand total	25,558

Senator SCHMITT. I put it in as an example where there isn't close coordination between headquarters and the regional commissioners.

Mr. DAVIS. If $50,000 was used for purposes you described, I would agree this is not good utilization of money.

MOVEMENT OF THE OV-1C MOHAWK

Senator SCHMITT. The Albuquerque radar activity, in cooperation between the FAA and the Customs Service, has been I think a model of good interagency cooperation. However, apparently the aircraft that could best serve that area with that cooperation are not assigned. Specifically, the OV-1C Mohawk seems to work best in that kind of environment. Would you expect that Mohawks would be soon assigned to that situation?

Mr. DAVIS. I have to defer to the Commissioner. We can look into it and supply you the information for the record.

Mr. ASACK. The aircraft, to the best of my knowledge, sir, has been moved from San Antonio to El Paso.

Senator SCHMITT. Excellent. Maybe we can start to see a little higher interdiction rate along that corridor which all the activity in Florida I think has opened up again.

Mr. Chairman, I will have a number of questions for the record on this.

Senator CHILES. Thank you very much. I will have some for the record, too. We can't spent all of our time on air interdiction. You can tell we are very interested in it.

GENERAL OVERSIGHT HEARING

Senator SCHMITT. Mr. Chairman, I might suggest, if we can work it in, after we have gotten through this unbelievably compressed appropriations activity in the subcommittee, that it might be well to have just a general oversight hearing on the question of the Service. It is not only this area but there are others that I know you are interested in and I certainly am. Maybe we can consider that.

Senator CHILES. We will certainly see what we can do on that.

MIAMI INTERNATIONAL AIRPORT FACILITY OPENING

My understanding is the Miami facility is to open partially this week. Is that right?

Mr. CHASEN. Yes, sir. The latest advice we have is it will be open this week, either today or tomorrow.

Senator CHILES. Sixty percent of it?

Mr. CHASEN. Sixty percent will be open.

Senator CHILES. Sixty percent of the new facility will be open?

Mr. CHASEN. Yes.

Senator CHILES. We did get the 21 employees on hand, the new employees to open it?

Mr. CHASEN. Yes, sir. Plus the fact, and I don't think we have had a chance to advise you of this, we have detailed, in order to assure smooth operation, on a TDY basis a number of inspectors, 49 additional inspectors.

Senator CHILES. You have detailed 49 additional inspectors as well as the 21 new inspectors, but that will be temporary to get it operating?

Mr. CHASEN. Senator, Dick Judy came up here and advised me that he wanted to make certain that the opening of the new facility was a success. We want to be sure we can staff the old facility and the new facility and be ready for almost any emergency. So we have detailed additional people there. I will be there Monday. We are meeting with the chamber of commerce. We will review what has happened over the past few days.

Senator CHILES. How have the sort of coordination meetings been going since our meeting in Miami?

Mr. CHASEN. We held them as per commitment. I have been down to Miami a couple times. Dick Judy has been up here. I feel we have made substantial progress.

There is one problem, and that relates to the budget for the Immigration Service, which is outside of our control. But that will be flushed up at our meeting on Monday when the INS has to indicate what problems they have.

But as far as Customs is concerned, we have met with both INS and the airport people and there is another meeting scheduled this coming Monday.

Senator CHILES. Good.

CRIMINAL MISCONDUCT BY CUSTOMS EMPLOYEES

Since January 1980 there has been considerable publicity concerning criminal misconduct by some Customs employees assigned to the New York region and its three area offices. So far I understand that the grand jury has returned 10 indictments and more are expected.

What is your assessment as to the magnitude of the allegations of criminal misconduct, and do you believe that it is limited to the New York region?

Mr. CHASEN. There have been 25 arrests so far and 11 guilty pleas. The investigation is ongoing. I can't go into details. We have similar investigations in all of our regions. But I would guess that the New York region would probably be the largest.

That is something, as Mr. Davis said, the Customs Service initiated on it own, and we hope to clean up our own problem ourselves, with the aid of the Inspector General of main Treasury.

Senator CHILES. I think it is certainly to your credit that Customs began its own investigation of the matter and has worked cooperatively with the Justice Department in this regard. I am concerned as to whether future Bureau Commissioners would have the same reaction you did.

INSPECTOR GENERAL FUNCTION AT TREASURY

Yesterday we discussed the desirability of strengthening the Inspector General function at Treasury. What is your view with regard to the need for a stronger Inspector General function at Treasury to help avoid and to investigate matters that involve misconduct of people in Customs and the other branches of Treasury?

Mr. CHASEN. I am personally satisfied with the setup the way it is. I think that what made the difference here was not the structure between us and the Treasury Department. Our internal affairs group was a reactive organization. It would only move when a complaint was brought to it. We reorganized and I was fortunate to be able to move Mr. George Corcoran, who used to be head of our Office of Investigations, into this position as Assistant Commissioner for Management Integrity. Under Mr. Corcoran's direction we started a proactive program, the concept being not to wait for information but to move out on our own with our own active programs. We were able then to capitalize on the information which was available and move out in New York. At that point in time we had the full cooperation of main Treasury.

I think we make a very good team. So I would prefer the present setup because we are able to use our own people who understand in depth how Customs works, from how the import specialist works to the patrol officer. So I think it makes for a better balanced effort.

Senator CHILES. Well, I can understand your view. Perhaps if I were sitting where you are I would have the same view. But sitting up here, I sure don't share it. Let me tell you why.

With you as the Commissioner that is maybe going to be exactly the result. But what we see time after time is that you get into a situation where it goes back to being reactive. It goes back to you don't rock the boat. You get along so you go along. If you don't have someone with the role of going out there and looking for the problem, and the rest of us knowing that there is somebody with that role, then things get lax.

I don't think you have that at Treasury now under the present setup, the kind of role you should have in the way we have set up the Inspectors General in other places. I think we are going to have to strengthen that.

Mr. DAVIS. Mr. Chairman, I almost hesitate to put an opinion in here, however, I recognize that you prefer to see something of a statutory mold. Without addressing that issue, I just want to say that since the Inspector General in Treasury came on board in September 1978, he has prodded and worked with the agencies. Also, oversight, particularly in sensitive investigations, has been provided to make certain that the work was being done and things were being followed up.

I am not authorized to speak for the Department on a particular proposal, however, I want to assure you that the system has worked. The Inspector General as well as the people like Commissioner Chasen attempt to be proactive and recognize that that is our obligation.

REDUCTION OF THE NUMBER OF REGIONS

Senator CHILES. Customs currently has some nine regional headquarters with 1,588 positions funded at $42,141,000 for this fiscal year. At a recent hearing before the House Committee on Ways and Means, I understand, Mr. Chasen, that you agreed with the GAO recommendation which said that the number of regional headquarters should be reduced from nine to six. Is that correct?

Mr. CHASEN. Yes, sir. When I came on board about 3 years ago, a report was in preparation to study the amount of regions. At that time I signed off on this report which reduced the regions from nine to six. I recommended one region for the southwest corridor.

The problem comes as to what would be the regional headquarters. I think for that reason no one has done anything about the recommendation. But I do believe there would be more efficiency and financial savings if we had a lesser amount of regions.

Senator CHILES. Well, if no one is ever going to do anything about it, we will never have less regions. We will still have nine. Reducing the number of regions to six would allow us to put some more people in the field; you are certainly under constraints all the time, it looks like, with the number of people you have? How do we get there from here? Maybe this committee should just put in the money for six. [Laughter.]

Mr. DAVIS. I would make one request, Senator. If you put in money for six, specify where they should be and who are the winners and who are the losers.

Senator CHILES. I think that is exactly the problem. Calhoun doesn't want the ball.

Mr. DAVIS. I think in this situation one of the issues that prevented some change was the long, drawn out process of considering whether it should be a part of the border management agency. This put a halt on making other kinds of regional changes until that worked its way out. Now that this program is not actively being considered, the issue then comes up again. I think it is in the Commissioner's prepared remarks that we do recognize there are some savings that can be made even in the existing regional structure by thinning out the regions. He has commissioned work to do that, similar to the headquarters effort, which resulted in a reduction of about 400 positions.

POSSIBLE TRANSFER OF POSITIONS

Mr. CHASEN. You know, Senator, we did make a study of headquarters. We are now doing it in each of the regions. We hope that we will be able to reallocate our strength to where it is really needed from where it might not be needed.

TRANSFERRING HEADQUARTERS POSITIONS

Senator CHILES. Last year we were told Customs was transferring headquarter positions to the field. As of last May, 100 positions had been transferred. How many have been transferred so far this fiscal year? What is your target number?

Mr. CHASEN. I think 200 have been transferred.

Senator CHILES. Two hundred have been transferred?

Mr. CHASEN. Yes, sir. We are now studying what we can transfer from region to region if there are excesses in one region as compared to another.

Senator CHILES. How many people make up a regional headquarters staff?

Mr. CHASEN. It would vary by the site of the region, but originally when I came to Customs my own estimate was that the headquarters might have 15 or 20 percent too many people. That might have been a reasonably good guess.

The same thing might apply to each regional headquarters, except each region has its own personality. For example, in Florida, which is less commercial and primarily oriented to enforcement, I do believe, and with this experiment we are running right now, I think more inspectors are needed there. Maybe I had better not mention the region, but New York, for example, I think is overstaffed. We are trying to prove it now. So that is really what we are trying to do.

Senator CHILES. We have been hearing about that report for a long time. When is that report going to be finished?

Mr. CHASEN. July is when it is due, sir. We moved very quickly once we got the report on headquarters. We will move quickly after we get the report on the regions. That will be for all nine regions in July.

OVERTIME PAY CAP

Senator CHILES. Last year the committee placed a $20,000 a year overtime pay cap on the amount of overtime pay any Customs employee could earn. In fiscal year 1977, 337 Customs employees earned more than $20,000 and three received over $39,000 in overtime pay caps. To permit the agency to adjust to this cap, 200 additional positions were added. The committee also asked for a report on the steps needed to reduce the cap to $15,000 for fiscal year 1981.

I notice in that report that 79 inspectors, based on the experience of the first 11 pay periods, were projected to go over the $20,000 cap this year.

What steps are being taken to make sure that everyone at Customs lives within the $20,000 pay cap?

Mr. CHASEN. This $20,000 cap is a problem for us. For one thing, it is a test for our managers, for which we are holding them accountable. We do have an alarm system built in so that as certain levels are reached, we monitor from headquarters the amount of overtime our inspectors are working.

As of today, we have approximately 92 inspectors; though if they continued at the rate they are going, they would exceed the $20,000 cap. We do have quite a few inspectors working, for example, at a one-man border station, who are working overtime, and it doesn't make sense while these inspectors are accruing overtime to send another inspector over there so the first inspector can avoid the $20,000 cap.

I believe personally that we can achieve the $20,000 cap. I think it is a good idea, providing you give the Commissioner of Customs the authority to waive that in very special cases according to his judgment, because there are going to be a number of cases where we are going to have difficulty avoiding exceeding the $20,000 cap.

As to the $15,000 limit, that is another problem. That may be difficult. It may be almost impossible to handle that because if you take all of our inspectors who are involved in this kind of overtime, they average $10,000 apiece, so $15,000 is going to be very difficult to manage as contrasted with $20,000. We think we are going to have serious problems ahead.

Mr. ARCHEY. I also, Senator, would like to add that our year to date—that would be as of April 1—on the 1911 category of overtime, we are about $800,000 below the 1979 level for the same time. That is a significant amount. That does not include the 7 percent raise to our inspectors. herefore, they are making more this year than they were making last year. But we are down about $800,000.

We also anticipate that if the cap were $15,000, we would have approximately 1,600 inspectors who would see a $15,000 cap.

Senator SCHMITT. Would you yield on that point, Mr. Chairman?

Senator CHILES. Yes.

200 ADDITIONAL INSPECTOR POSITIONS

Senator SCHMITT. The committee also authorized at that time 200 additional inspection personnel in an effort to provide sufficient manpower for inspections. How many of these 200 new positions have been filled?

Mr. WILSON. All 200 of those positions were allocated last August. At the time we allocated those 200 positions, we had 125 inspector vacancies. Since that time we have also authorized 50 additional inspectors for the Miami airport area. So if you take all of those into consideration, considering we have 195 inspector vacancies today, that means we have filled at the minimum, even excluding any turnover of inspectors, 180. So we have a net increase of 180 inspectors on the rolls since that time.

Senator SCHMITT. But the 200 was tied in part to that cap on oversight, right? We are trying to give you more personnel at less cost.

Mr. ARCHEY. Those 200, when we made the allocation Mr. Wilson was referencing, we used as the criteria the $20,000 cap as to where it would hurt the most. That was the major criteria for the allocation of those 200 inspectors.

Senator SCHMITT. But we are still about 200 short then, right?

Mr. WILSON. One hundred and ninety-five.

Senator SCHMITT. Am I mistaken, does that really mean we haven't done anything toward——

Mr. ARCHEY. No; that includes turnover since August. That would include attrition, and as Mr. Wilson said, we filled 180. We have had a number of vacancies just through normal attrition. We also had the freeze that came on February 29.

Senator SCHMITT. What is the net gain from last year? Is that 180?

Mr. ARCHEY. The net gain is 180. We also have requested or put in for an exception to the freeze on filling the inspector vacancies. That is going through the process now.

REVENUE COLLECTED BY INSPECTORS

Senator CHILES. You gave the statistics at the start, Mr. Chasen, about revenues that Customs takes in. Do you have any kind of estimate of the revenue a Custom agent raises? We are trying to cut employment all the time because we are trying to cut the Government's payroll. Customs I think is a little like IRS. They are units of production rather than taking away. Do you have any way of estimating what an inspector in effect adds to the revenue of the federal treasury after we have deducted his salary?

Mr. CHASEN. No. We have no way of doing that. I know that IRS does it. But I am not so sure in our case that it would give you a true and faithful answer. It depends on what the location is, and there are different conditions in each of our regions. It is very difficult to get a standard on that.

Mr. ARCHEY. One thing we have discovered, for example, on the inspectors at an airport and the amount of duty collected, that if you were to totally control for enforcement and just control for duty, that it costs us about $16 for every dollar of duty that we raise because it is very small declarations of traveling passengers.

Mr. CHASEN. I used to be a frequent international traveler, and one of the first things I did when I came to Customs was to try to find out what we did collect at airports. We collect about $18 or $20 million. I estimated it probably costs us $50 to $60 million to collect that. But we have to do it. It is the law.

I would like to see some legislation that might make it easier for the inspector because he does have to collect the duty once the item is declared. But it is an expensive, big ticket for us.

Senator CHILES. You mean if we even raise the duty requirements that you could declare and save the Government money?

Mr. CHASEN. If we said, "If your duty is up to $50, you don't have to declare; just go through," that would save us money.

I know of many times, and I am sure it has happened to you, when you wait in line while somebody is paying $4.25. You have to wait 5, 10 minutes. I always felt that was unnecessary.

Senator CHILES. I will have some more questions that I will submit for the record. Senator Schmitt?

HOUSTON PERSONNEL CLASSIFICATION

Senator SCHMITT. The Civil Service Commission, now the Office of Personnel Management, suspended the authority of the Dallas regional office to hire or promote anyone due to gross violations of law. While that authority has recently been returned, the Civil Service continues to monitor closely the activities of the Dallas office and I suspect other offices.

Can you explain why this earlier action was necessary and what the Customs Service is doing to prevent further occurrences like that?

Mr. CHASEN. I think that was an incident that happened about 3 years ago.

Mr. ARCHEY. It was. It was out of our Houston region. But OPM's regional office is in Dallas. It had to do with a number of classification problems and administrative classification drawoffs.

I think as of last week when I talked to our regional commissioner there has been a considerable turn of events. We have a new regional commissioner in Houston who came on board in the last couple of weeks. OPM is going to provide a 6-month detail to the regional office to assist them in undoing these problems and to preclude any of these types of personnel problems from recurring. That person is going to come to the Houston region sometime within the next month.

INTERRELATIONSHIP BETWEEN REGIONS

Senator SCHMITT. It is my understanding that traditionally there have been difficulties between regional commissioners, personality conflicts or territorial conflicts or something like that. Is that a problem? If so, what has been done to resolve it?

Mr. CHASEN. I am sure you know the original Customs Service had Collectors of Customs who were appointed by the President. At the same time, the Commissioner at Customs was appointed by the Secretary of the Treasury.

I am told of one case where the Commissioner at Customs said he was going to visit the Collector of Customs in California, and the Collector of Customs told him if he would come into his territory, he would have him shot.

I tell this story because it wasn't until 1965 that Collectors of Customs became regional commissioners. There was a tradition going back to 1789 where the Collector of Customs was a strong, central personality, even though he was regional.

It has been very difficult from a management point of view to change that type of thinking. My predecessors apparently did not feel as strongly as I do about centralization. We now have five new regional commissioners out of the nine. I think that there is a whole new spirit out there. I don't think that there is much strength in this fiefdom type of thinking that formerly existed. I think it is being broken down and we are finally becoming one Customs Service.

Senator SCHMITT. So is it five out of the nine that have been replaced recently?

Mr. CHASEN. Yes, sir.

Senator SCHMITT. Have there been reassignments also?

Mr. CHASEN. There have been some reassignments and retirements. This February 29 retirement period led to the retirement of three of our regional commissioners.

Senator SCHMITT. Could you provide for our record, before the markup, a list of these transfers and others at the district division level that have happened since October 1, 1978, with a very brief reason?

Mr. CHASEN. 1978, Senator?

Senator SCHMITT. 1978, so we get some historical perspective on it.

NEWSPAPER STATEMENTS ABOUT THE REGIONAL COMMISSIONER, NEW YORK

Do you wish to express any view on the charges that have been brought against the former regional commissioner of New York and the current regional commissioner of Miami?

Mr. CHASEN. The former regional commissioner of New York has only had charges leveled against him in the newspapers—some of which were grossly untrue and unfair; and others are still under evaluation. He was not transferred to Miami. He was brought to——

Senator SCHMITT. No. I am saying there have been charges I think also relative to the regional commissioner in Miami.

Mr. CHASEN. I know of no charges there.

Mr. DAVIS. I am not aware of any charges.

Mr. CHASEN. I know of no charges against the regional commissioner in Miami.

Senator SCHMITT. Are there other investigations of possible impropriety being conducted within the Customs Service?

Mr. CHASEN. I think I said earlier we have ongoing investigations in all nine regions but none against regional commissioners.

Senator SCHMITT. Thank you.

Senator CHILES. Our other questions we will submit for the record.

Mr. CHASEN. Thank you.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

REDUCING THE OVERTIME PAY CAP TO $15,000

Question: Eighty-one percent of the inspectors now projected to exceed the $20,000 pay cap were either the New York, Miami or San Francisco Region. Doesn't that suggest that more resources should be assigned to those three regions?

Answer: As of February 23, 1980, there were 79 Customs officers earning overtime at a rate in excess of $20,000. Sixty-four, 81 percent, of these officers were located in the New York, Miami and Los Angeles Regions. As of March 22, 1980, these figures peaked at 92 Customs officers with 78 or 85 percent in the stated regions. Since that time the special measures designed to reduce individual overtime earnings noted above have been introduced and seem to be producing the desired results. The latest figures, April 5, 1980, show that 82 Customs officers are now at an overtime earnings rate level above the $20,000 limit and that 78 percent of them are in the noted regions. Further, some of the officers who significantly exceeded this high rate have been removed from the overtime assignment roster or their number of overtime assignments have been significantly reduced and the overtime assignments redistributed among other Customs officers. We anticipate that we will continue to experience an improvement in those inspectors currently registering overtime at a rate in excess of $20,000.

While it will be difficult to meet the overtime cap at some locations, particularly at some one-inspector locations which experience very heavy traffic during the summer, e.g. Friday Harbor, Washington and Oswego, New York, we presently are very hopeful of meeting the overtime limit, without additional manpower, by redirecting resources and reducing overtime overall.

Question: What is the status of the workload study that Customs told us about last year that is to be used to develop criteria for staff assignments to ports?

Answer: The Inspectional Work Measurement System is already operational. The system, for which data is being collected on a regular schedule, provides managers with a detailed relationship between workload and staffing. Using the data, workload standards have been prepared for use in allocating staffing. We anticipate the system will be applied to the 40 highest workload volume ports, including about 80 percent of the workload and 75 percent of the inspectional staffing. An analysis of these locations is currently underway. The feasibility of similar techniques to other functional groups is being tested.

Question: How many additional inspectors will be needed if the overtime cap is reduced to $15,000 for fiscal year 1981?

Answer: Based on current estimates, overtime earnings for 1600 employees will be in excess of $15,000 in fiscal year 1980. Measures introduced this year will reduce this figure. Since, however, overtime is based on an employees rate of compensation and a pay raise is anticipated for fiscal year 1981, the benefits gained from the above noted overtime reduction measures will be somewhat offset. Until we gain a full year's experience on the effectiveness of the overtime reduction measures, it is difficult to accurately estimate the number of inspectors who might go over a $15,000 overtime earnings limitation. We, however, presently anticipate that in excess of 1500 inspectors would exceed a $15,000 overtime earnings limit. In order to absorb these overtime services Customs would need an additional 250 inspectors.

SPEEDING THE ENTRY OF INTERNATIONAL TRAVELERS AT AIRPORTS AND SEAPORTS

I understand that the one-stop inspection processes will only be in place at approximately 40 percent of the airports by the end of 1981. Further expansions cannot be made until inspection facilities are remodeled or new ones are built. Because facility changes cannot be made quickly and Customs has no firm plans to expand one-stop or citizen bypass inspections beyond 1981, about 60 percent of the international air travelers will continue to be processed under a two-stop process for the foreseeable future.

While one-stop and citizen bypass are long-term solutions Customs will need to be concerned about various short-term techniques to speed passenger processing. One such technique that GAO has urged is for Customs to drop the requirement to see luggage before making the primary inspection.

The inspections made by Customs at our border ports account for 90 percent of international passenger arrivals. These inspections according to GAO are usually made without seeing any passenger luggage or other articles in the vehicle trunks. At airports and seaports, however, Customs has argued that it must see a passenger's luggage before it makes the primary inspection.

Question: Does Customs assume that air and sea travelers are greater enforcement risks? What specific studies of enforcement results have been made that justify the assumption?

Answer: Sea travelers have been determined to generally be much lesser enforcement risks than either air passengers or land border crossers. A recent study of enforcement data, however, showed that the average air passenger is a much higher risk than is the average land border passenger.

Three times as many narcotic and non-narcotic seizures were made per air passenger as were made per passenger arriving by other methods in FY 78. Much of the land border traffic consists of regular commuter traffic or of travelers who have only made a very brief trip into Canada or Mexico. Because air passengers are much more likely to be arriving directly or indirectly from "source" countries, however, significant seizures of hard narcotics, i.e., heroin and cocaine, are much more frequent at airports. While only 9 percent of all arriving travelers came by air in FY 78, over 93 percent of all heroin and cocaine seized from passengers occurred at airports.

Question: If Air and Sea travelers are not greater enforcement risks, why then doesn't Customs drop the requirement of inspecting passenger luggage before making the primary inspection, as this would greatly speed passenger processing?

Answer: Because vessel passengers are generally considered to be lower risk, prebaggage claim inspection is currently the accepted Customs policy at most of our busier seaports.

Prebaggage claim inspection was previously attempted at U.S. airports in 1968; it was discovered, however, that passenger facilitation was not generally improved and in many instances both enforcement and facilitation efforts were actually impeded. The system works well in theory and it can work during hours of slow traffic, i.e., it works only when it is not really needed. During slow traffic or during the first aircraft arrival of a peak period, Customs could take advantage of baggage delivery time by inspecting passengers as they trickled out of the Immigration area. As the peak would build and passenger queuing lines would lengthen, however, it was found that baggage delivery time was not a factor in overall passenger facilitation. By the time a passenger could present himself for inspection, his baggage would already have been delivered. Our experience was one of mass confusion at the baggage claim and secondary checkpoint areas and a resultant decrease in both passenger control and enforcement results.

Question: How does Treasury justify the position that acceptance of this recommendation to speed the entry of air and sea travelers would become the abandonment of Customs responsibilities to enforce its laws when over 90 percent of all international travelers are subjected to a primary inspection without seeing any luggage or other articles in the vehicles' trunks and concealed areas?

Answer: Some of the differences of workload characteristics and enforcement risks between air and land border passengers have been pointed out. While we do not take the position that pre-baggage claim inspection at airports would cause Customs to abandon its law enforcement responsibilities, there is no doubt that observation of a passenger's baggage is an essential element in an inspector's selectivity process. Mr. Peter Bensinger, Administrator of the Drug Enforcement Administration, has stated that implementation of this GAO recommendation would be detrimental to enforcement of the Federal narcotic and other entry laws as it would not only enable smugglers to disassociate themselves from their contraband, but would also lead to increased use of baggage for contraband concealment.

Question: According to GAO there are other significant factors that cause delays that Customs could remedy. According to GAO these factors include: no workload standards for processing passengers, no consensus on what the primary inspection should include, and little knowledge as to the enforcement alternatives as well as the significance of those few violations that do occur.

Answer: We agree with these GAO findings. Although the different types of passenger workload and inspectional facilities at the various U.S. airports require some differences in inspectional processing procedures, one of our FY 80 goals is to devise and implement uniform national standards for inspectional staffing and procedures. The proposed standards are currently being reviewed by top field management before final issuance and implementation.

Question: Since less than 1/10 of 1 percent of incoming travelers are found in violation of Customs laws and regulations, why can't Customs be more selective in its inspection process including more selectivity in the primary inspection process?

Answer: Since Customs began changing its inspectional philosophy from one of complete baggage inspection to one of concentrating on a brief passenger interview before selecting a small minority of passengers for more thorough inspection, the percentage of secondary examinations has continually decreased. The percentage of secondary referrals at U.S. airports during FY 78, at which the percentage of violators was three times qreater than the overall 0.1 percent figure mentioned, was 24 percent of all arriving passengers. Similar data for FY 79 has shown that secondary referrals decreased to 15 percent. Of this 15 percent, 4 percent were referred for mandatory duty collection as a result of voluntary compliance. Of the remaining 11 percent, a large portion were referred because of various mandatory requirements for Customs and other Government agencies and not because of smuggling suspicion.

Through increased and improved selectivity, secondary referral rates should continue to decline.

Question: What specific progress, if any, has been made in the development of a Workload Measurement System for Inspectors?

Answer: The Inspection Work Measurement System is already operational and is beginning to be used. The system provides Customs managers with detailed information on the relationship of inspection workloads and manpower resources. This information is collected in a one week sample each quarter and compared with other more aggregate workload data. Inspection work measurement data is collected at the work site level where the work is performed and the data is summarized for the station, port, district and region levels.

Customs management is using this work measurement data to develop servicewide workload standards and to develop an inspector allocation technique based on these standards. The application of the inspector allocation technique is being concentrated upon determining inspector staffing levels for 40 high workload volume ports. Our analysis of inspectional workloads indicates that 80 percent of the workload (i.e., land vehicles, air passengers, cargo importations) is processed at these locations. Also, 75 percent of our inspectors are now assigned to these same locations.

In addition to developing an inspector allocation technique, the work measurement data can be used for numerous special studies. Our regional offices are beginning to use this data to study inspector overtime, cargo processing workload below the port level, and inspector resource utilization.

There are other factors contributing to the delays and other passenger inconveniences that are beyond the inspection services' control. These factors include: inadequate and poorly located facilities, baggage delivery delays, airline schedules, and the rapid growth of the airline industry.

Question: Why can't the inspection services work with the airlines and airport authorities to seek short and long-term resolution of the factors contributing to delays and passenger inconveniences similar to what is now being done in Miami?

Answer: Customs works with airlines and airport authorities on both the national and local levels to seek remedies for passenger congestion and delays. Examples of such interaction include regularly held facilitation meetings with the air carrier industry at Customs Headquarters, testing and nationwide implementation of the Customs Accelerated Passenger Inspection System (CAPIS) and the Citizens Bypass and One-Stop inspection systems.

Although there are few formal facilitation committees in operation, the rapport and cooperation with the various airport authorities, air carriers, and air industry associations, such as ATA and NACA, have generally been excellent. We are currently working closely with the air carrier industry to improve Customs landing rights procedures, which will have a direct impact on airline scheduling. We have also recently initiated steps to request accelerated baggage delivery and to also simplify Customs procedures regarding in-transit, unaccompanied, and unclaimed baggage. Customs always works closely with airports or airlines when they begin planning for new construction or existing facility renovation.

Question: How many airport facilitation committees are currently in existence?

Answer: Local Customs managers regularly attend facilitation committee meetings at JFK and Miami. Most major U.S. airports have facilitation committees consisting of airport operators, air carriers, and local governing authorities. Customs managers attend such meetings when the agenda includes Federal inspection concerns.

Question: Does Customs have a policy of attempting to establish these committees?

Answer: We do not currently have such a policy. We have, however, proposed the establishment of scheduling committees at major U.S. airports to grant landing rights, resolve scheduling problems, ensure optimum facility utilization, and relieve congestion and delay problems. This concept of scheduling committees, which would consist of airport operators, air carrier representatives, and local Customs managers, has recently been determined by the CAB to probably be in contradiction to antitrust laws, however.

Question: Are there additional resource requirements for this year and Fiscal Year 1981 in order to adequately staff these new facilities.

Answer: Exclusive of the reprogrammed funds in 1980 for staffing the Miami facility, there are no additional resources in 1980 or in the FY 1981 Budget Request for these new facilities. Unless additional reprogramming becomes possible, in order to adequately staff the facilities additional resources are required.

OFFICE OF INVESTIGATIONS

Last year the Committee was concerned to learn that over 75 percent of the cases of suspected violation of the major Customs laws that were investigated resulted in no adverse findings. Because of this the Committee felt that the office was devoting too much of its resources to low priority cases. Consequently, the Committee asked for Customs to study this matter and report back to us on ways to target the Office of Investigations resources on higher priority cases.

Question: Have the new criteria been implemented? Please describe for the Committee the nature of the criteria.

Answer: Selectivity criteria were discussed in-depth at a meeting in Washington with the principal managers in the Office of Investigations. We are making excellent progress in developing criteria, and we should have an operational program underway in the field -- barring major technical problems -- by June 1, 1980. These selectivity criteria are intended to permit Customs investigators to focus their efforts on high quality, major investigative cases offering a significant potential for law enforcement accomplishments. We fully recognize that there are risks to this "selective" law enforcement approach in that we may "miss" or overlook cases, but we believe this is the most effective manner in which our limited manpower can be targeted against major Customs violators.

Question: The Report prepared for the Committee indicated that the Office of Investigations has a force of 610 special agents deployed in 74 domestic and foreign field offices and that

Customs will attempt to close inactive offices and to concentrate its investigative force in areas with the greatest potential for high priority cases.

When will this process be completed? In what geographical areas do you expect to be concentrating the special agents?

Answer: Customs Headquarters, in conjunction with its investigative field managers has made a preliminary decision on the closing of 18 smaller investigative offices. When a final decision is reached on specific closings, probably in the next several months, it is our intention to assign the special agents to the large metropolitan centers, in particular to those areas that we have targeted major Customs violators.

Question: The 1981 request for the Office shows a 5 percent reduction compared to the 1980 level to reflect the view that a portion of the Office's resources have been focused on non-essential work. This action was recommended by the Committee and by GAO last year. Why shouldn't this reduction be larger -- perhaps 10 percent to 15 percent?

Answer: The 5 percent reduction is part of Custom's goal to balance investigative resource requirements to the workload of high potential cases for which Customs is responsible. We have already developed specific plans to accommodate the 5 percent reduction -- which translates into a cut of 48 positions in the FY 81 investigative function -- by closing down a number of our smaller field offices and by eliminating vacant positions. We believe that we can accommodate the 5 percent cut and minimize the impact on investigative performance and productivity by carefully targeting where the cuts should be taken. Finally, with regard to the possibility of larger reductions, the workload has significantly changed since the GAO study. Today a growing percentage of Customs investigative resources must be allocated to the high priority Currency Enforcement Program, which is directed to illegal currency transfers related to major drug smuggling conspiracies. These investigative efforts have immobilized major drug traffickers. In addition, we believe that any further reductions will diminish Customs capability to respond to not only the currency requirements but to other high priorities.

INSPECTORS NEEDED FOR NEW AIRPORTS

Last year the committee learned after the Customs budget had been approved by the Congress that additional resources had not been specifically included in the 1980 budget to staff the new airport facilities that are scheduled to open this year.

Question: What new airport facilities opened in Fiscal Year 1980?

Answer: Albuquerque International Airport opened for regularly scheduled commercial service in FY 80 and by the end of FY 80 a complete one-stop facility will have been constructed. Other airports completing either new construction or major facility renovation and expansion are the Miami, Los Angeles, Honolulu, Baltimore, and New Orleans airports.

Question: What facilities are scheduled to be opened in Fiscal Year 1981?

Answer: Either new construction or current facility expansion are scheduled for completion in FY 81 at the following airports: Houston, Atlanta, Miami, San Antonio, and Orlando.

Question: How have the inspection service requirements for these facilities been provided for?

Answer: Additional inspector positions for the new airport facility at Miami were obtained by reprogramming resources within Customs. To date no additional resources have been allocated for the new airport facilities at Honolulu and Los Angeles.

U.S. CUSTOMS SERVICE MISCLASSIFIES TOBACCO IMPORTS

Question: According to a recent GAO report (11/6/79), imported tobacco that has been processed into strips for use in the manufacture of cigars and cigarettes is incorrectly classified by the U.S. Customs service as scrap tobacco. The tobacco strips are in fact the principal output of a threshing process and should be classified as stemmed cigar or cigarette filler leaf tobacco. Since these tariff classifications carry higher duty rates than scrap tobacco, as much as $188 million in import duties may have been lost in the last ten years. Customs' use of the scrap classification likely has been a factor in the doubling of tobacco scrap imports during this period.

Apparently Customs' classification approach over the years has remained essentially static despite changes in industry practices.

What can you tell us about this situation, Mr. Chasen?

Answer: American producers of fluecured or burley cigarette leaf tobacco have protested the classification of this tobacco as scrap tobacco under item 170.60, at 16.1 cents per pound. They urge its classification as stemmed cigarette leaf under item 170.35. This is now at 41 cents per pound. They place emphasis on the economic losses sustained by the individual farmers as a result of the tobacco not being classified at the higher rate of duty.

On the other side, briefs were filed by the tobacco processors who support the current classification of the product.

Customs has reviewed these positions and the GAO report of November 6, 1979, and has announced a decision on May 16, 1980. After an extensive review of a petition from an American producer of fluecured tobacco the Customs Service concluded that what had been classified as scrap tobacco is neither scrap nor as the petition had asked stemmed cigarette leaf filler tobacco. The tobacco in question is in fact processed to the extent that it may be considered a manufactured product.

STATUS OF EFFORTS TO MORE EFFECTIVELY DEAL WITH THE INCREASING VOLUME OF CARGO

In Recent Years there has been a steady rise in the quantity of imported cargo. During this time the Customs work force has been static. The tremendous increases in the volume of imports and technological changes in transportation have diluted the effectiveness of Customs traditional cargo processing procedures. Accordingly, Customs has cited two specifc efforts -- the accelerated cargo clearance and entry processing test (ACCEPT) and the cargo compliance measurement program (CCMP) -- which are expected to serve as the hub of a more efficient system for cargo processing.

Question: What are the specific results of Customs evaluation of the effectiveness of selective cargo inspections -- the ACCEPT tests and the CCMP efforts?

Answer: A formal evaluation of the Accelerated Cargo Clearance and Entry Processing Test (ACCEPT) has been completed by a disinterested Customs group and their report reviewed by Headquarters management officials. The concept of an automated system for selectivity in cargo processing was endorsed and found to be a valid and beneficial method of expediting the release of a large volume of imported merchandise while concentrating our attention and expertise on that small remaining portion selected out for thorough examination. In general, the evaluation pointed out minor problems that were inherent in the implementation of the test concept and are not really problems with the concept itself.

Question: Last year, Customs advised the committee that a plan for a comprehensive selective cargo inspection system should be ready in the Fall of 1979. What are the revised milestones for the plan and the implementation of a selective cargo inspection system?

Answer: A task force has been created and is presently working at Customs Headquarters to incorporate the findings of the evaluation committee into a revised plan for future expansion of the ACCEPT concept. The task force is subjecting the ACCEPT reconfiguration to a rigorous application of the program development system. Their timetable projects the completion of an optimum operational design by May 8, 1980. If this plan is acceptable to all levels of Customs management, it will be submitted to Customs Office of Data Systems for design of a technical ADP solution incorporating both hardware configuration and programming design. When this step has been completed and approved, a test site will be selected for further testing of the modified concept. Prior to actual commencement of any subsequent test, a system will be implemented at the test site to capture a specified set of pretest data that can be utilized to evaluate the impact and success or failure of the program.

Question: Within a context of limited future resources and the increasing volume of imports, what is being done to speed the development of a selectivity oriented systems for cargo processing.

Answer: The answer to the preceeding question generally addresses this question also. In addition, a separate task force is conducting an in-depth program development application of the principles of selectivity as they relate to both entry processing and cargo processing.

AUTOMATED MERCHANDISE PROCESSING SYSTEM

Question: The Automated Merchandise Processing System is intended to be a computer-assisted program aimed at expediting and improving Customs control over all merchandise entering the United States. The last comprehensive plan for the development and implementation of these systems was completed in 1974. However, implementation of the various systems became fragmented in the interim. In addition, we understand that Customs management is now concerned whether or not the 1974 plan meets Customs requirements for the 1980s.

Last year Customs advised this committee that the Agency was quite pleased with the results of initial implementation of some of the AMPS System.

Question: What is the current status of the AMPS program?

Answer: Customs has implemented the on-line revenue collection portion of the Automated Merchandise Processing System nationwide in 65 locations which process 85% of all Customs collections ($8.2 billion). The remaining locations (5) will be implemented this year. The on-line nationwide quota processing system of AMPS has also been implemented in 23 major ports which account for 80% of all quota transactions nationwide. The remainder are communicated to the nearest port with on-line capabilities or to Customs Headquarters for immediate response for quota control.

An on-line Air Manifest Clearance processing system is in pilot-testing at Los Angeles Airport with an air-carrier which provides for direct transmission of air manifests to Customs computers for on-line terminal clearance of manifests by Customs inspectors at the time of aircraft arrival.

Other features of the AMPS systems such as In-Bond Control, On-line Bond processing and billing by account are in various phases of development.

Question: If Customs is reevaluating its requirements for an automated entry system, what is the impact on the milestones previously established?

Answer: Customs is still committed to an automated entry system. The first stage of the entry system, namely the collection portion has been implemented. For cost-effective implementation Customs has designed and is now pilot-testing in conjunction with brokers in Baltimore and Philadelphia an automated broker interface system whereby brokers who have automated capabilities transmit their entries to Customs computers and by-pass the full data entry operation by Customs data entry clerks. This will enable Customs to pursue automated entry processing at a reduced cost to the government and efficient error correction and quicker entry processing to participating brokers.

Question: When will Customs have a plan that sets forth its requirements for the 1980s?

Answer: Customs has produced an automation plan for AMPS systems as part of its A-11 report to OMB which outlines system improvements to Customs operations into 1983, and by the end of this fiscal year will have a full plan into the mid-1980's.

Question: To what extent has Customs reevaluated its requirements for a computer to support the AMPS program:

Answer: Customs has reviewed and reevaluated its need for computer support for all merchandise processing and administrative systems based on current plan. All appropriate studies have been completed. Procurement authority has been requested from GSA to acquire the necessary computer.

Question: When will Customs be ready to acquire a computer to support all the systems for its Automated Merchandise Processing Program?

Answer: Customs plans to acquire a computer have been set as part of a formal ZBBO with the Treasury Department. The plan calls for release of the RFP in July of 1980, award of the Customs computer in May 1981, and delivery in November 1982.

NON-COMPLIANCE WITH OCCUPATIONAL HEALTH AND SAFETY LAWS

Question: According to the justification material (p. 3) Customs is in compliance with only 23% of the Occupational Health and Safety Laws.

The justification material indicated that the additional $525,000 requested will be used primarily for the personnel costs of a health and safety unit and not to actually correct defects in the work place. Is that correct?

Answer: This statement is not correct. Approximately $110,000 or 20% of the $525,000 will be spent to buy safety equipment including:

> Personnal protective equipment for the protection of our employees against injuries to head, eyes, hearing, body, legs, feet, etc.
>
> Personnal flotation equipment for marine crews and the procurement of such items as strobe lights, goggles, fire blankets, etc.
>
> Monitoring equipment (sound, carbon monoxide, etc.) which can be used to detect problem areas.

Question: Why aren't the funds proposed to be spent on actually correcting the various defects instead of just adding more staff?

Answer: Over $100,000 will be spent on specific safety equipment. Part of this same equipment will be used to monitor potential problem areas. As these areas are identified, appropriate safety equipment then can be utilized to improve and make safe the working areas of our employees.

BUDGET REDUCTIONS DUE TO THE TRANSFER OF THE ANTIDUMPING AND COUNTERVAILING DUTY PROGRAM NONRECURRING COSTS AND SAVINGS

Question: A reduction of $1,000,000 is displayed for the transfer of the antidumping and countervailing duty program for Commerce for the period of October 1, 1979 to January 1, 1980.

As the full year cost of the program was at least $5,300,000 shouldn't this reduction be at least $1,325,000?

Answer: The transfer of the Antidumping and Countervailing Duty Program to the Department of Commerce was effective January 2, 1980. Since the transfer was effective after the start of the fiscal year, the obligation authority was provided via an appropriation transfer to the Department of Commerce. This transfer was for $5,271,000 and was for the period January 2, 1980, through September 30, 1980.

Included in the transfer to Commerce was the major portion of the $3.3 million Appropriation Amendment provided to the Customs Service for FY 1980. The basic funding assumption of that amendment was implementation after January 1, 1980, and specifically an average position recruitment date in mid-February.

The President's Budget reflects the appropriation transfer of $5,271,000 in FY 1980. In addition, a reduction of $1,000,000 is displayed in arriving at the FY 1981 proposed authorized level. The $1 million reduction is the remainder of the FY 1980 resources for the program, which were not transferred to the Department of Commerce.

Stated another way, $1 million was the cost to the Customs Service for the Antidumping and Countervailing Duty Program for the period October 1, 1979, through January 1, 1980. The program reduction reflected in the FY 1981 request completes the transfer of resources authorized by Reorganization Plan Number 3 of 1979.

SUPPORT SERVICE AND FACILITIES

Question: An additional $2,000,000 is requested for support services and facilities. What specifically are these additional funds for?

Answer: The resources requested for support services and facilities is an attempt to recapture program effectiveness which has been lost because of spiraling inflation. Resources to offset inflation were last provided in FY 1979. Specifically, these funds are required to operate and maintain our aircraft, vessels, and vehicles. Without increased resources to offset inflation we will be forced to cut back utilization of this equipment and further restrict the effectiveness of Customs Programs.

In the President's Revised Budget of March 31, 1980, this specific line item has been changed to a request for $500,000. This downward adjustment reflects the offset of $1.5 million in additional User Charges which will be available in FY 1981.

ADDITIONAL 200 INSPECTOR POSITIONS

Question: How many of the 200 additional inspection personnel have been hired in fiscal year 1980?

Answer: It is difficult to identify precisely the inspector positions filled since August 1979 with the new 200 inspector positions authorized at that time. All 200 positions were allocated to the field in August 1979. At that time we had 125 inspector positions vacant, many of them at the same locations. Since these positions were allocated, we have had turnover of inspector positions of approximately 24 a month. We also have allocated additional inspector positions since December 1979. On April 15 we had 195 inspector vacancies; thus, our net increase of filled inspector positions since August 1979 was 180.

Question: When will all the authorized additional inspection personnel be aboard?

Answer: On March 14, 1980, the President directed that curtailment of Federal civilian hiring be undertaken as a means of reducing spending. As a result, for the duration of this hiring limitation our full-time permanent employment base is our February 29, 1980, level of employment. Also, this base will decrease as we have separations after that date since we will be able to fill only 50 percent of such separations. Since the President has set no date at this time for the termination of the hiring limitation, it is impossible to predict when all of our additional inspection personnel will be aboard.

Question: We have been advised that employee background investigations delay getting the inspectors on board. Why can't the employment process be speeded up by having the new inspectors start work prior to the completion of the background investigation?

Answer: The Customs Inspector is the nation's first line of defense against smuggling and protecting the revenue generated by the Customs service. Inspectors face large segments of the travelling public, importers, etc., in one-on-one situations where the Inspector must deal with criminals and potential violators of the law as well as routine situations. The Treasury Enforcement System, which contains law enforcement and personal information generated by Customs and other agencies, is accessed constantly by Inspectors to assist them in performing their duties. In addition, Inspectors are required to make seizures, arrests, enforce criminal laws, and enforce laws and regulations of other agencies. All these factors combine to make the position of Customs Inspector one where integrity is of the utmost importance. For these reasons the position of Customs Inspector has been designated a noncritical-sensitive position. Chapter 732 of the Federal Personnel Manual states that the minimum investigation allowable for a noncritical-sensitive position is a National Agency Check and Inquiries (NACI) which shall normally be completed prior to appointment. Chapter 732 of the Treasury Personnel Management Manual provides a waiver for this requirement, however; it states that the minimum investigation required before a waiver can be requested is a favorably completed National Agency Check (NAC). Both of these regulations are based on the concept of preappointment investigation for sensitive positions as promulgated by Executive Order 10450.

Once a person is hired, personnel regulations make it extremely difficult to discharge or even reassign individuals based on derogatory background information. Normally action against employees must be based on job performance or misconduct in current employment. This makes a post-appointment investigation practically useless as a management tool to weed out undesirable applicants. Background investigations function as intended and are most effective when used as a basis for preappointment hiring determination. Customs has always felt that Customs Inspector positions are sensitive and demand a preappointment evaluation of applicants.

The NACI and the NAC are conducted by the Office of Personnel Management. These checks normally take 90-120 days and 60-90 days respectively. Such delays for preappointment checks are unacceptable. We have, therefore, developed in the past year a limited investigation equivalent to the NACI which we conduct on a preappointment basis. We have given priority to Inspector investigations and normally complete our investigation in 30 days. In emergency situations even this short time frame has been reduced. We feel that it is important to the continued integrity of the Customs Service to select only honest, trustworthy, capable Customs Inspectors for positions of such high public trust. We believe that the limited investigation conducted by the Customs investigators on a preappointment basis strikes the proper balance between the need to serve the public and the need to protect the integrity of the Service.

Question: We were recently informed by the National Treasury Employees' Union (NTEU) that none of the 200 positions have been filled. I understand that NTEU is not correct on that point.

Answer: As we stated previously, we have had a net increase of 180 filled inspection positions since the 200 inspection positions were allocated. Also, on April 15 we had a total of only 195 vacant inspection positions. Obviously, the NTEU statement is not correct.

Question: In a recent month Customs had 167 vacant inspector positions. How many are vacant now?

Answer: As of April 15, 1980, we had 195 vacant inspector positions. This increase reflects the heavy retirements at the end of February so that they could receive the benefits of the cost-of-living increases available to retirees at that time.

Question: In view of the clearance delay at our airports and seaports around the country, why can't these positions be filled?

Answer: The President's hiring limitation restricts our ability to fill positions at this time. Although we have established the filling of inspector positions as our number-one priority within the hiring limitation guidelines, it is possible that the number of inspector vacancies will increase because we can fill only one-half of all future vacancies.

REDUCTION PROPOSED FOR INSPECTOR POSITIONS

Question: I noticed in the justification material that Customs is proposing to reduce the inspection and control function by 13 positions and $413,000. What is the justification for this decrease in view of the increasing workload?

Answer: In order to provide adequate resources for uncontrollable increase it will be necessary to slightly reduce this activity. This is not a reduction of positions, but a reduction of the number of work years that can be achieved from the resources that are proposed for FY 1981.

TACTICAL INTERDICTION PROGRAM

Question: How much of the Tactical Interdiction Program for both positions and dollars is assigned to the Air, Land, and Sea Programs?

Answer: That information can be obtained from this table.

Tactical Interdiction Distribution By Program

	Average Positions	Amount
Air Program	153	$17,428,000
Marine Program	182	6,849,000
Land Program	1,132	37,130,000
Subtotal	1,467	$61,407,000
Direct Support		
Systems Development	20	1,507,000
Communications	67	2,828,000
TECS	30	1,308,000
Space	--	1,959,000
Administrative Support	119	3,436,000
	1,703	$72,445,000

QUESTION: How is the Customs land border patrol program coordinated with the INS effort? How effective is the Border Patrol Program (please provide output data)?

Answer: It should first be pointed out that the missions of the two Patrol programs are dissimilar. The Customs Patrol mission is to interdict contraband and smuggled merchandise, while that of the INS Border Patrol is to detect and apprehend illegal aliens. Despite these differences,

coordination at all organizational levels has been accomplished.

Included are:

1. Headquarters level meetings to develop plans for the joint use of technical equipment. This has resulted in:
    a. A cross service agreement on the joint use of sensor equipment.
    b. The mutual use of some communications facilities.
    c. A test, now in progress, of the use of radio frequency scanners to permit monitoring of operational radio frequencies by each Patrol force.

2. A cross training agreement which has been completed at the working level and is now being provided to new recruits at the Federal Law Enforcement Training Center.

3. Access to enforcement data files of both agencies is provided through the El Paso Intelligence Center.

4. Regularly scheduled meetings of field management and supervisory level personnel are conducted to maintain and improve coordination at that level.

5. Daily personal contact between journeyman level Patrol officers is strongly encouraged.

In response to the second part of this question concerning the effectiveness of the Customs Patrol program, the following statistics for FY 1979 are provided.

NARCOTICS AND DRUG SEIZURES

Heroin

Number of Seizures	27
Quantity (lbs.)	18

Cocaine

Number of Seizures	168
Quantity (lbs.)	512

Hashish

Number of Seizures	162
Quantity (lbs.)	47605

Marijuana

Number of Seizures	1463
Quantity (lbs.)	3,447,063

Opium and Morphine

Number of Seizures	29
Quantity (lbs.)	26

Other Drugs

Number of Seizures	165
Quantity (Tablets)	14,590,091

Total Narcotics Seizures	2014
Total Narcotics Value	$2,209,405,603

ARRESTS AND NON-NARCOTIC SEIZURES

Arrests	10,269

Prohibited Non-Narcotic

Seizures	489

Vehicles

Seizures	483
Quantity	560
Value	$1,951,079

Aircraft

Seizures	111
Quantity	116
Value	$8,053,871

Vessels

Seizures	245
Quantity	266
Value	$34,646,981

Total Non-Narcotic

Seizures	6,111
Value	$63,065,372

CPO Manyears Expended (Includes Headquarters)	1,211

Arms

Seizures	133
Quantity	786
Value	$31,453

Ammunition

Seizures	92
Quantity	47,070
Value	$9,338

Monetary Instruments

Seizures	672
Value	$9,825,155

General Merchandise

Seizures	3,886
Value	$8,547,495

Question: How is the Customs Sea Program coordinated with the Coast Guard? Why can't all sea patrol programs be left entirely to the Coast Guard?

Answer: An interagency agreement between the Coast Guard and the Customs Service was signed on July 10, 1978. This agreement dedicates both agencies to work in close cooperation, providing mutual support with respect to the suppression of trafficking in contraband on all waters where the United States has jurisdiction.

All marine special operations are jointly planned and conducted by the Coast Guard and Customs Service. Examples of very successful special operations conducted during FY 1979 are Aquacept II in the Customs Baltimore Region and Gulfnet '79 in the Customs New Orleans Region.

In high threat marine smuggling areas regularly scheduled meetings are held between field management level personnel. Among the results of these meetings is the temporary assignment of Customs Patrol officers to Coast Guard vessels to assist in the boarding of suspect vessels and when appropriate, the arrest of violators. During the meetings referred to above, the exchange of enforcement information/intelligence provides the impetus for close cooperation at the working level. This is accomplished by the exchange of radios to provide rapid communications between Coast Guard and Customs vessels. This permits close coordination of enforcement actions during which the Customs Service often provide in-shore and close coastal support to the Coast Guard.

A complete response to the second part of this question concerning why all sea patrol programs can't be left entirely to the Coast Guard, could best be provided by representatives of the Coast Guard. However, from the perspective of the Customs Service, the following reasons are apparent.

1. The primary mission of the Coast Guard is not law enforcement; rather it is search and rescue.
2. The Coast Guard has recently deemphasized its law enforcement functions to conserve resources for their primary function. We can therefore expect less support from them in our interdiction efforts.

3. Present law requires that all Coast Guard vessels be plainly marked. The development of marine smuggling information/intelligence and conducting surveillance dictates the use of unmarked boats.

4. The Coast Guard has neither the manpower, equipment nor funds to adequately patrol the more than 95,000 miles of shoreline of the United States. Neither, for that matter, does the Customs Service. However, through close coordination and use of the resources unique to each agency, more success in the interdiction effort is realized than either agency could expect working alone.

AIR INTERDICTION PROGRAM - CUSTOMS

Question: What are Customs' views on the assertion that an effective air interdiction program requires a substantial improvement in adequate, timely, and reliable intelligence data?

Answer: Since the air interdiction strategy is limited in resources when compared to the amount of border to be monitored, increased effectiveness will depend on being in the "right" area at the "right" time. Therefore, the Air Program must have direct access to both tactical and strategic intelligence. The capability must exist to collect, correlate and analyze information to assist in the interdiction of smugglers. Inherent in this process is the requirement for a means to communicate the results of this analysis to action oriented operational personnel and for a feedback system to evaluate results achieved. The end result is the necessity for creating a program oriented intelligence sub-system unique to Patrol but integrated into Customs overall intelligence planning. Outputs of this sub-system shall be used to:

(a) Optimally locate detection equipment and interceptors to enhance the probability of interdiction.
(b) Allocate available Program resources.
(c) Assist in improved sorting. (e.g. develop profiles, TECS base, lookouts and probable cause for the use of covert tracking devices)
(d) Assist in placement of ground forces during the apprehension phase of a mission.

Objectives of Tactical Information

Information that can be successfully used in Air Program tactical operations must identify at least one of the following points:

Point A - The foreign loading place or a foreign fuel stop while loaded.

Point B - The point of border intrusion or any portion of the inbound domestic flight route.

Point C - The U.S. destination or first U.S. place of landing.

Additionally, the information must establish an appropriate time frame to permit effective enforcement actions at the identified points.

A second objective of information for tactical interdiction purposes is the development of probable cause. Probable cause information must establish, with a high degree of certainty, that a specific conveyance will be used contrary to Customs law within a specific time. If the information is of sufficient quality and reliability, a legally authorized covert tracking device installation will normally result.

Objectives of Strategic Information

Strategic information that can be productively utilized in the Air Program for operational planning or to make a determination as to asset allocation/placement must not only establish current activity but must provide predictive insight based on validated pattern projections.

AWACS Utilization

The Airborne Warning and Control System (AWACS) has the potential of providing tactical and strategic intelligence. In its most publicized application, AWACS radar can detect low flying aircraft (down to the ground) 200 miles away. This, of course, is excellent tactical intelligence and Customs is already taking advantage of this capability to aid the ASB's in their interdiction responsibilities. However, AWACS could also be used to document radar targets in order to add to the total data base related to the air smuggling threat. This would be particularly valuable because AWACS has the capability of detecting everything in the air space under surveillance. The resulting very accurate sampling of the air threat would be very valuable in determining where to place interdiction resources.

Question: What is Customs doing to obtain better intelligence data?

Answer: The U.S. Customs Service is engaged in both internal and external attempts to obtain better intelligence data. Internally on August 1, 1979, the U.S. Customs Service instituted a Headquarters reorganization to centralize all enforcement efforts into the Office of Border Operations, thus combining the management and direction of the former investigative, patrol and inspectional functions into a single office. Within the newly established Office of Border Operations, a staff element has been established as the single center for intelligence information and information gathering which reports directly to the Assistant Commissioner for Border Operations. This element, known as the Information Services Staff (ISS), is responsible for providing management, guidance and development to the information support and intelligence functions within the U.S. Customs Service and provides operational intelligence support and strategic assessments. In cooperation with operational offices, the staff develops information collection requirements and produces profiles, publications and statistical reports to support management and the operational elements. The staff disseminates tactical intelligence received from other agencies and coordinates interregional intelligence activities.

An initial assessment by this Staff was that the absence of a standardized procedure for information collection and dissemination by all appropriate elements reduced the overall effectiveness of the Customs Service. Therefore, an MBO objective of a Customswide collection plan to increase the quality and quantity of information received from Customs sources and external agencies and to utilize more effectively the data received in order to enhance Customs inspectional, interdictory and enforcement posture was adopted. Customs believes that central coordination of the receipt and dissemination of information from the various Customs operational elements and from outside agencies will greatly enhance the enforcement capabilities of the Service by concentrating collection priorities against the objectives established on a Customwide basis. The collection plan emphasizes data pertaining to areas identified as primary requirements of operational elements including narcotics interdiction, detection of smuggling techniques, and collection against corollary violations such as an illegal currency transaction and arms and munitions smuggling. A second National Level MBO applicable to both the Headquarters and all Regional Commissioners is designed to establish an effective measurement system of both the quality and quantity of intelligence produced by the various Customs components.

Externally in an attempt to increase the flow of intelligence, Customs established representation in the El Paso Intelligence Center (EPIC) in April 1976 and has since increased its personnel committment to the point that it now has the second largest number of personnel assigned. In addition, during April 1976 Customs detailed an Intelligence Specialist to the Drug Enforcement Administration (DEA) Headquarters and has maintained continuous representation within the DEA Office of Intelligence since that time. As a reciprocal measure, DEA detailed a representative to the Customs intelligence component in January 1980. Customs and DEA conduct almost constant evaluation of the exchange of enforcement data and are constantly seeking methods to improve both the quality and quantity of intelligence available with regard to the narcotic enforcement effort.

In addition to exchange of data with DEA, Customs has identified its intelligence needs to other collectors within the intelligence community. This has been accomplished through such vehicles as the National Narcotics Intelligence Consumers Committee (NNICC) and various individual agencies. While narcotics enforcement is not a primary objective of the Central Intelligence Agency (CIA) and the Defense Intelligence Agency (DIA), Customs does receive and utilize intelligence from both of these sources. As with data from other sources, intelligence received from these agencies is processed for inclusion in the Treasury Enforcement Communications System (TECS) or in special intelligence publications which are distributed to our field enforcement personnel.

Currently the TECS network consists of more than 1,000 terminals. Most are located at land-border crossings along the Canadian and Mexican borders, key sea and air ports of entry, field offices of the Customs Office of Investigations and the Bureau of Alcohol, Tobacco and Firearms. These terminals have immediate access to records in the TECS data base containing information from U.S. Customs and other Treasury enforcement and investigative files. These records contain information on suspect individuals, businesses, vehicles, aircraft, and vessels. The TECS terminals can also access NCIC records on wanted persons, vehicles, license plates, articles, guns, securities, boats, and criminal histories. The TECS host computer is a sophisticated, large-scale computer system operated by the U.S. Customs Service, Law Enforcement Systems Division. The TECS system is operational 24 hours-a-day, seven days-a-week. In order to expand the amount of narcotics related intelligence in the TECS system, Customs and DEA established a formal agreement regarding the exchange of computerized data in July 1979. The agreement provides for access by each agency to appropriate data from the agency's system with special emphasis on known or suspected narcotics subjects of interest.

During the past several years, numerous special enforcement efforts have been targetted against the illicit traffic from South America which passes through the Caribbean and enters the south-eastern U.S. Operation names such as GULFNET, BULLRING, STOPGAP, SNOWBIRD, and BOOMER FALCON are familiar to Customs, DEA and Coast Guard personnel who are assigned in that area since each of the operations was a joint effort involving all of the above services with much of the coordination being accomplished through EPIC. Other cooperative efforts are non-operational such as the publication of reference materials for use by enforcement officers and intelligence collectors.

In view of the wide-range of responsibilities enforced by the U.S. Customs Service, it is apparent that we must constantly attempt to increase our intelligence capability in order to process the persons and cargo within the time restraints demanded by the travelling and importing communities. We intend to continue to seek all available methods to improve our service to the public while maintaining an effective enforcement posture.

Question: While the study concentrates on needed improvement to intercept low flying aircraft the high performance aircraft issue is not adequately addressed. High performance aircraft used in smuggling hard narcotics and dangerous drugs can enter the U.S. by a regular flight pattern and stand almost a 100% chance of no detection. What is Customs doing to deal with this type of smuggling operation?

Answer: The revamped strategy stresses the need to make major increases in sorting capability (determine legal from non-legal traffic) to address the problem in question.

The sorting plan has two parts as follows:

Part one: positive control entry procedures which provides a primary sorting between aircraft in compliance and those in non-compliance (suspect).

Part two: a secondary sort of those aircraft in apparent compliance by a comparison of flight plan information (automated) against suspect data banks and finally against a subsequent Customs clearance to ensure a "closed loop" system for entering aircraft from foreign countries.

Attached for additional information is the proposed Sorting Plan outline.

Sorting Sub-System

A viable sorting system will be composed of the following elements:

(a) Establishment of positive control entry procedures into U.S. Air Space.
(b) FAA Foreign Flight Plan data link.
(c) Suspect profiles.
(d) Unattended Beacon Alerting Surveillance System (UBASS).

Entry Procedures

The basic building block of the sorting system is the establishment of positive control (Instrument Procedures) over entering aircraft. This can be achieved by changes to existing laws and regulations as follows; mandatory flight plans, specific transponder codes for identification, arrival and departure corridors, (coinciding with airway routes), and minimum flight altitude requirements. Extension of the designated airports of entry concept across the whole southern border, no overflight exemption except for commercial air carriers on instrument flight plans (IFR) and any aircraft claiming exemption due to not landing on foreign soil must have been under positive control for the portion of the flight in foreign air space. Aircraft not adhering to the entry requirements would be considered suspect and liable to intercept.

FAA Data Link

Data Link to Interface Foreign Flight Plan Information to TECS on Real Time basis to Provide Aircraft Identification for Specific Radar Targets.

Inputs	(1)	Foreign Flight Plans A) Outbound Flight Plans (This would also provide intent element for OI Currency cases.) B) Inbound Flight Plans
	(2)	TECS Base
	(3)	PAIRS Information
	(4)	Lookouts
	(5)	Aircraft Registration and Pilot License File
Process	(1)	Correlation of flight plan with target radar position
Output		- Aircraft with no flight plan
Process	(2)	Comparison of flight plan with PAIRS information
Output		- List of aircraft overdue on Customs clearance
Process	(3)	Comparison of flight plan aircraft number and pilot name with lookouts, TECS base, aircraft registration and pilot license information.
Output		- Alarm on incoming/outgoing suspects - Aircraft with false registration - Pilot with false license

Suspect Profiles

One of the outputs of the intelligence sub-system will be to provide suspect profile data for the sorting system. Aircraft targets meeting the profile will be subject to intercept.

Such data requirements as general aviation traffic patterns, locations of unused air strips, terrain characteristics and past information on smuggler operations and methodologies will be utilized.

UBASS

This system will provide the capability to detect a "Beeper" tagged suspect in the border area. The equipment consists of an unattended receiver tuned to the "Beeper" frequency which relays detected signals to the command and control sub-system or to Sector Communications Centers. Interceptors are then launched with homing sensors (D/F gear) to close on the suspect until acquisition is made by on-board radar or night vision equipment.

The sorting sub-system is located in the Command and Control Center and is used by assigned duty personnel for launch decisions.

Question: Customs has estimated that its current air interdiction results are minimal and can be equated to 1% of the estimated 6,700 intrusions or 6% of the estimated 1,000 aircraft.

Since Customs has made no quantitative or qualitative assessment of its overall air program results, how valid is this estimate?

Answer: A quantitative assessment of results by the Customs Air Program has been made. The number of aircraft seized annually (which were involved in the smuggling of contraband and for which the program received credit) has averaged 67 aircraft over the past three fiscal years.

This number when compared to the threat estimate of 6,700 intrusions and 1,000 aircraft yields 1% of the intrusions and 6.7% of the aircraft involved. The validity of the estimate rests on the threat analysis done by SRI International which is believed to be credible and is consistent with earlier efforts to quantify the threat. However, the bottom line when comparing results to the threat is that the current number of interdictions is not sufficient to inhibit the use of aircraft for contraband smuggling.

Question: A recent analyses of two Customs' Air Support Branches disclosed that both the aircraft and pilot utilization was minimal. The reason cited for low utilization was the lack of adequate intelligence data on smuggling operations. The study makes an assumption that if the proposed program is successful for 3% of the air smuggling attempts that 20% of the aircraft used in smuggling would be removed. What is the basis of the 3% estimate?

Answer: The 3% estimate is based on two analyses: one the DRI threat estimate and the other on the following interdiction system probability equation;

$$P_E = P_D \times P_S \times P_I \times P_A$$

That is, the probability of effectiveness (P_E) of the interdiction system equals the probability of accomplishing the following; Detecting aircraft crossing the border (P_D) Sorting the suspect targets from the inbound traffic (P_S) Intercepting the suspect target (P_I) and apprehending the aircraft crew (P_A). An interdiction system effectiveness of 3% ($P_E = 3\%$) acting against an estimated 6,700 intrusions annually (SRI) will yield 201 aircraft which then approximates 20% of the 1,000 aircraft estimated (SRI) to be in the smuggling population at any given time. The interdiction system probability percentage goals needed to obtain 3% effectiveness are as follows:

$$P_E = P_D \times P_S \times P_I \times P_A$$

$$(.03) = (.056) \quad (.8) \quad (.83) \quad (.8)$$

Question: Except for the additional marijuana seizures, explain Customs rationale as to the cost effectiveness of a $93 million program that will result in the interdiction of an estimated 12 additional aircraft involved in the smuggling of high value drugs.

Answer: The conveyance of contraband by aircraft across U.S. borders is well established and highly successful. Rapid movement of contraband and the difficulty of detecting illicit border crossings make this system attractive to the smuggler. The smuggler is motivated by greed and will eventually transport any cargo that provides substantial profits. In addition to drugs and the subsequent flow of corrupt money the smuggling system itself poses a threat.

If the proposed module produces positive tests results, the specialized and effective equipments to be acquired over the next 5 years at an estimated cost of $93 million would be to achieve the volume of interdictions likely to affect this air smuggling threat. Without the acquisition of such state-of-the-art equipment, or changes in law relating to marijuana, it is highly unlikely that the present seizure rate will ever dampen or decrease the smuggling of contraband by aircraft. Effectiveness of the interdiction system is keyed to how well it functions against intruding aircraft. The seizure of drugs occurs as a result of apprehending border intruders, the quantity and types of these seizures may subsequently be compared to cost, however, the program does not provide the traditionally acceptable cost effectiveness measurements and must be additionally evaluated by social and political criteria to determine its full value.

Finally the revamped program would be incrementally established permitting time to validate outputs against resource inputs, make evaluations and adjust funding levels as appropriate.

Question: What other alternatives in lieu of the proposed program were studied?

Answer: Four master interdiction strategies were studied. The strategy that utilized aircraft as part of the interdiction system was selected as being the optimal and most logical master strategy. The other three strategies were discarded for lack of effect on the problem, acceptability by a democracy, or were prohibitive in cost.

Subsequently four program alternatives utilizing interdiction aircraft were developed. These were comprised of common subsystem components, with differences in the amount of effective interdiction equipment, dependence on tactical (case) intelligence, and the estimated effect on the problem. One alternative would have operated the program almost totally on case intelligence with minimum enforcement equipment being moved to the exact place and time required for each interdiction (lack of sufficient tactical, intelligence would preclude large volumes of such interdictions). At the other end of the alternative range, the program would function largely on strategic intelligence to place a greater quantity of interdiction equipment in the areas of highest intrusion activity and would operate during the most appropriate hours. This method still permits the system to react to tactical intelligence and has the greatest probability of achieving the desired volume of interdictions. Two other alternatives considered, represented hybrid points between the described program alternatives.

Question: What is the status of plans to conduct an operational test of the proposed revamped air program?

Answer: A broad plan for testing the recommended interdiction strategy has been developed. This plan is broken out into major management and operational sub-components. At this time, comprehensive and detailed work packages are being designed and developed for each sub-component. The projected start-up for the test is October 1980. The test will be closely monitored and evaluated throughout its execution.

Question: Without the assurances of the availability of precise advance intelligence on aircraft smuggling operations prior to the penetration of U.S. air space, the proposed program may well be doomed to a minimal successful effort. What are Customs views on this assessment?

Answer: The selected strategy does not depend on precise advance intelligence (tactical) for volume interdictions but is designed to be productive based on strategic intelligence. This strategic information regarding high volume intrusion areas, time frames, and profiles is essential to the programs output and is provided for in the intelligence plan.

BROKER MEETING - PALM SPRINGS

Question: On Wednesday and Thursday, February 13, and 14, 1980 were you in Palm Springs, California?

Answer: Yes, I was.

Question: Were any other Customs' officials in Palm Springs? If so, give me their names and titles.

Answer: Two other Customs' officials attended the meeting with me. They were Alfred R. DeAngelus, Assistant Commissioner, Commercial Operations, and Albert G. Bergesen, Regional Commissioner, Los Angeles.

Question: By attending the brokers' and importers' meeting in Palm Springs did not you and other top officials of the Customs Department compromise the Government's position with the individuals they regulate?

Answer: No, we did not compromise the Government's position as it relates to the brokers' and importers' industry. Our attendance at the meeting was purely a business relationship as we are required by law to deal with these people throughout the year. Brokers and importers continually visit me in Washington and our discussions are relative to the importing industry and regulations and procedures relating to that same industry. All travel expenses and related costs for the three Customs officials attending were borne by the Customs Service.

TRANSFER TO COMMERCE

Question: Two hundred positions were transferred from Customs to the Department of Commerce in the Dumping and Countervailing duty areas. Where does this decrease show in your budget?

Answer: Page one of the Customs Service Budget shows an appropriation transfer in FY 1980 to the Department of Commerce for the antidumping and countervailing duty program. This transfer was for 229 positions and $5,271,000 and represents that program cost for the period January 2, 1980, through September 30, 1980. Since the program for the first quarter of FY 1980 was paid by Customs, this cost is shown on page three of the Customs budget as reduction to reflect the completion of the transfer of resources to the Commerce Department.

ALCOHOL PROBLEM

Question Does Customs have a particular problem with alcoholic employees?

Answer No, the U.S. Customs Service does not have a particular problem with alcoholic employees. Only two (2) employees, of approximately 14,530 total employees, were terminated in FY 1979 for conduct or performance problems related to alcoholism abuse, after counseling efforts failed.

Question: On December 15, 1979, did you issue Manual Supplement #51735-02 which would prevent employees on a plane trip returning from a duty assignment from buying a drink; or prevent the three martini lunch; and prevent alcoholic beverages from being served at retirement parties?

Answer: Manual Supplement 51735-02, titled "Conduct and Employee Responsibilities; Alcoholic Beverage Use Provisions", dated December 5, 1979, was recently issued. These provisions on alcoholic beverage use are applicable if the outlined conditions are present in a situation. More specifically, the provisions would not prevent employees, on a plane trip returning from a duty assignment, from buying a drink if, for example, the employees are not in uniform, i.e., Customs insignias are not visibly displayed, and if they are not on official duty. Likewise, the provisions do not always prevent having a drink at lunch since the employee is not being compensated during lunch, and if he/she does not return to work under the influence of alcohol, etc. Finally, the provisions do not prevent alcoholic beverages from being served at retirement parties, provided the stated conditions are met. The provisions of Manual Supplement 51735-02 are provided.

Question: Why did you require each employee to affix his signature to a receipt for the aforesaid Manual Supplement and include this receipt in each employees personnel folder?

Answer: Each Customs employee is required to sign the receipt as acknowledgment of being provided the provisions on alcoholic beverage use. The Office of Personnel Management regulations (5 CFR 735) provide that each employee be furnished a copy of the agency regulations governing employee responsibilities and conduct. The subject issuance, as an amendment to the Customs Conduct and Employee Responsibilities regulation, is therefore provided to each employee. The signed receipt in the official personnel folder provides a record that each employee has received the standards of conduct for which they are responsible, in accordance with the OPM regulations.

DISTRIBUTION: G-11

POLICIES & PROCEDURES MANUAL

MANUAL SUPPLEMENT

NUMBER: 41735-02
ISSUE DATE: December 5, 1979
EXPIRES: Indefinite

SUBJECT: Conduct and Employee Responsibilities; Alcoholic Beverage Use Provisions

ALL EMPLOYEES MUST SIGN ATTACHED RECEIPT FOR THIS ISSUANCE

PURPOSE

This issuance sets forth revised alcoholic beverage use provisions which are applicable to all Customs employees.

ALCOHOLIC BEVERAGE USE PROVISIONS

A. No employee will report for duty (or be on duty) under the influence of alcohol, including after meal and leave periods. "Under the influence of alcohol", for the purposes of this provision, means that an employee's effectiveness is considered to be impaired to a degree which might constitute a hazard to himself or to others, or to property, or that an employee is otherwise unable to perform his assigned duties by reason of his consumption of alcoholic beverages.

B. No employee may consume alcoholic beverages while on official duty unless specifically authorized in the line of duty. Employees are not considered on official duty during any period of the day during which the employee is not compensated.

C. No employee in uniform may consume alcoholic beverages in public places while on-duty or during off-duty hours. Employees are not considered to be in uniform when the employee wears a jacket, coat, sweater or similar garment and Customs insignias are not visibly displayed.

D. No employee carrying a Government issued or authorized firearm may consume alcoholic beverages unless specifically authorized in the line of duty.

E. No employee may consume alcoholic beverages within eight hours before flight duty in an aircraft.

F. Any law or non-Customs regulation dealing with consumption of alcoholic beverages with respect to a particular activity that is more restrictive than this policy will be applicable.

G. Supervisors are reminded of their responsibility to encourage employees who may have an alcohol related problem to seek treatment in accordance with the Customs Alcohol Abuse Program. All employees shall receive copies of Policies and Procedures Manual Transmittal No. 41000-45 and any such amendment thereto.

H. When an employee's use of alcohol interferes with the efficient and safe performance of the employee's assigned duties, reduces the employee's dependability or reflects discredit on the agency, supervisors will take either or both of the following actions:

   1. Non-disciplinary procedures under which an employee with an alcohol problem is offered rehabilitative assistance.

   2. Invoking regular disciplinary procedures for dealing with problem employees.

ACTION

Section 41735, dated December 29, 1977, requires that every employee be provided with a copy of any subsequent addition, deletion, amendment or interpretive issuance concerning an employee's conduct and responsibilities and that the employee will acknowledge receipt of such material. Since this Manual Supplement incorporates revised instructions into Section 41735, all employees must sign the receipt enclosed with this issuance. Supervisors of employees covered by this issuance shall ensure that it is distributed to the employees, signed for, witnessed, and that the receipts are forwarded to the appropriate servicing personnel office maintaining the employee's Official Personnel Folder. Because it is possible that an issuance could be lost in shipment, in which case a supervisor would not know of its existence, all servicing personnel officers shall follow-up using their personnel records to verify that the issuance has been received and signed for by all employees within their respective jurisdictions.

COORDINATION

These alcoholic beverage use provisions have been negotiated with the National Treasury Employees Union (NTEU).

EFFECT ON OTHER DOCUMENTS

This issuance supersedes the provisions on the "Use of Intoxicants" as set forth in the Conduct and Employee Responsibilities Section 41735.2U, dated December 29, 1977.

EXPIRATION

This Manual Supplement will expire upon its incorporation into Section 41735 of the Policies and Procedures Manual.

R. E. Chasen
Commissioner of Customs

Attachment to:
Manual Supplement
Number 41735-02
dated Dec. 5, 1979

FOR OFFICIAL PERSONNEL FOLDER

I hereby acknowledge receipt of Manual Supplement Number 41735-02 which outlines the alcoholic beverage use provisions for all Customs employees. I understand that I am fully responsible for familiarizing myself with and strictly adhering to the contents thereof.

(Signature)

(Title)

(Date)

Witnessed:

(Signature)

(Title)

(Date)

This receipt is considered a temporary record and is to be filed on the left side of the employee's Official Personnel Folder.

OIL GAUGING

Question: Was it your decision to remove Customs inspectors from the responsibility of gauging petroleum imports?

Answer: Customs inspectors have not been removed from the responsibility from gauging petroleum imports. In fact, Customs role and physical presence during gauging operations has been increased and will be mandatory upon publication of final rulemaking of amendments to the Customs Regulations, Part 151, which deals with the measurement and control of imported petroleum. The final rulemaking is presently under final review by the Treasury Department and should be published within the next few weeks.

Question: Were Customs inspectors replaced with independent gaugers paid by the oil importers?

Answer: In fact, not only were Customs inspectors not replaced by independent gaugers, the new Regulations limit the use of public gauger reports that the District Directors of Customs may accept and use. Previously the Customs Regulations provided for the use of a public gauger's report for an entire oil import transaction. The new Regulations permit a public gauger's report only if a Customs inspector has been present for an independent measure. Customs will be a part of each import transaction and will no longer take an independent report about it. It should be noted here, however, that sometimes the independent gauger is paid by the importer and sometimes by the seller. Customs has no evidence the independent gauging companies are anything other than disinterested parties in the transaction. In fact, they often do not enjoy a friendly relationship with oil companies, who would rather use their own employees for measurement. Oil importers must employ them in non-related transactions in order to make international claims against either suppliers or carriers for oil losses. Claims can only be substantiated in international courts when the courts are sure of the impartiality of the independent gaugers.

Question: With respect to petroleum imports, did you ever have any meetings with the American Petroleum Institute and any of its officials?

Answer: Yes. Customs officials have met with American Petroleum Institute officials on several occasions.

Question: Where were these meetings held and if they were not held at Customs Headquarters, why not?

Answer: During 1979, only one meeting with representatives of the American Petroleum Institute was held. It was in August 1979, and was at Customs Headquarters. At this time, members of the API's Committee on Petroleum Measurement presented discussions on innovations and improvements in the field of oil measurement to a conference of Directors of Customs Regional Laboratories. Additionally, Customs officers attended conventions of the API's COPM group in both October of 1979 and April of 1980, to present Customs new requirements for imported oil and in order to keep abreast of the continuing developments and innovations in the measurement field.

During 1980, with the exception of the COPM convention, Customs and the API met, with other concerned individuals, including a members of a Congressional staff, at a public hearing on January 8, 1980, in Customs Headquarters to discuss Customs proposed regulatory changes. Notice of this meeting was published in the Federal Register.

Question: President Carter issued a proclamation that we would import no more Iranian oil. Inasmuch as Customs gaugers are precluded from checking on the importation of Iranian oil, and this duty is now performed by independent gaugers, do you feel that we have adequate knowledge of the amount and sources of foreign oil coming into the United States?

Answer: As stated earlier, Customs has increased its mandatory involvement in the measurement of oil, and no import transaction is reported by an independent gauger alone. Customs is involved in each and every transaction and we can reliably report that we have proper and adequate controls on imported oil and that we reliably and accurately provide statistics about these imports. Additionally, our laboratory has developed, in response to the Iranian boycott, sophisticated means of identifying characteristics of imported oil, so that we can determined by sample that Iranian oil is not entering the United States in accordance with Presidential Proclamation 4702 of November 12, 1979.

OVERTIME

Question: Within seven days, please provide the committee with a report on the amount of overtime paid to Customs inspectors, and the post of duty of each inspector making over $40,000 per year and what you have done to bring overtime abuses under control.

Answer: In Fiscal Year 1979 the amount of overtime paid to Inspection and Control personnel, primarily inspectors, was $53,859,488. During this period, 347 inspectors earned more than $40,000 in both overtime and salary. In regards to the steps taken to bring overtime abuses under control, a year and half ago I asked all top level managers to personally look into the amount of overtime they were authorizing.

As a result of their review and the review of our Office of Inspection, policy and procedural direction was formulated for the purpose of improved management of inspectional overtime. On June 12, 1979, the formal policy was issued. We are supplying a copy of that directive. Also following is a listing of the post of duty of those inspectors who have earned more than $40,000.

DISTRIBUTION: G-11

POLICIES & PROCEDURES MANUAL

MANUAL SUPPLEMENT

NUMBER: 2132-05

ISSUE DATE: June 12, 1979

EXPIRES: Indefinite

SUBJECT: MANAGEMENT OF INSPECTIONAL OVERTIME

REFERENCES: Policy Statement 2100-06 and Manual Supplement 2132-03, dated May 10, 1978, and Policy Statement 2100-08.

1. PURPOSE:

To provide policy direction for procedural reform and control in the management of inspectional overtime.

2. BACKGROUND:

The policy and procedural direction stated herein has been formulated for the purpose of improved management of inspectional overtime in an effort to provide the most efficient and economical service possible, commensurate with the mission of the service.

The policies and direction stated herein do not alter or change the policies and procedures set forth in the Manual Supplement 2132-03 of May 10, 1978, entitled "Assignment of Personnel to Inspectional Activities".

3. ACTION:

(a) The policy and procedural direction which follows will be implemented upon receipt.

(b) Policy and Procedural Direction

(1) No one above the grade of GS-13 will participate in inspectional overtime in any capacity.

(2) GS-13's who participate in overtime will do so only within the first line supervisory overtime pool (consisting of GS-11's and 12's) in the capacity of a first line supervisor.

(3) Supervisors shall not be assigned to perform the duties of bargaining unit employees on overtime solely for the purpose of eliminating or reducing the overtime of unit employees; except to avoid "overwork" as called for under Section III-B of the Manual Supplement 2132-03 of May 10, 1978, "Assignment of Personnel to Inspectional Activities".

(4) Maximum proration of assignments among parties-in-interest, including the government, is obligatory.

(5) Inspectors, or other employees assigned to inspectional overtime on Sundays or holidays, will hold themselves available for the full eight hours (or nine, when a one hour meal

break is applicable) of the assigned tour, and shall be "available" in the sense of being readily reached and in a location and state of readiness enabling themselves to report for duty upon short notice. The time allowed for travel in reporting back to duty will be determined by local and district management.

(6) Commensurate with current levels of staffing and distribution of workload, tours of duty, not on overtime, will be established at seaports where ship arrivals, or gauging, routinely occur outside of the currently established hours on other than Sundays or holidays.

(7) Commensurate with current levels of staffing and distribution of workload, tours of duty, not on overtime, will be established to cover the hours of 6:00 a.m. to 8:00 a.m., and/or 5:00 p.m. to 7:00 p.m. at seaports where there are regularly recurring requests for services for the release of cargo during those hours on other than Sundays and holidays.

(8) Commensurate with current levels of staffing and distribution of workload, tours of duty, not on overtime, will be established at airports, where air cargo arrivals or air cargo releases routinely require 6:00 a.m. to 8:00 a.m., and/or 5:00 p.m. to 7:00 p.m. service.

(9) The actual supervision of the lading and sealing of ships stores or vessel supplies will be discontinued, except for enforcement purposes when determined necessary by the district director.

(10) All unlading will be under general supervision. Actual continuous on-site supervision of unlading will no longer be performed, except for enforcement of Customs and related laws when such supervision is deemed necessary by the district director, or when merchandise is being simultaneously examined or released. General supervision on overtime will consist of one inspector to cover an area, in which unlading is occurring, which is extensive enough to obtain coverage of the largest possible geographical area.

(11) When the district director deems it appropriate to have supervisory oversight of seaport overtime assignments, and there are three or more overtime assignments working in a seaport simultaneously, a supervisory inspector may be assigned to supervisory overtime. When there are nine or more simultaneous overtime assignments, two supervisors may be assigned, or when six or more overtime assignments are scattered over such a wide geographical area as to make supervision by one supervisor impractical.

(12) Advance outbound clearances of aircraft will be provided during regular hours. When advance clearance is prohibited by law or regulation such clearance will be granted at the time requested for clearance; otherwise, outbound clearances will not be done on overtime.

(13) Within the constraints of available staffing, service will be provided at all ports, Monday through Saturday, to eliminate recurring assigned FEPA overtime on Saturday.

(14) Compliance with Manual Supplement 2132-03, Sec. I, B, 2, a, of May 10, 1978, requiring the establishment of shifts to cover scheduled air passenger arrivals, is mandatory.

(15) The use of overtime must be carefully scrutinized by all levels of management, including a review of the CF-6081's, 6440's, and overtime printouts by a non-participating district management official on a bi-weekly basis, and a periodic review by the regional Inspection and Control Division.

(16) Customs officers will accept licensed public gauger's reports as provided by C.R. 151.43, in lieu of gauging by Customs Inspectors, except that the district director may require gauging by inspectors when he has reason to suspect the reliability of the public gauger's reports, or for the purpose of establishing that reliability by a random gauging of not more than 5%. For six months immediately following the date of this issuance, all ports involved in gauging will maintain the full 5% reliability check.

(c) Accountability for the implementation of this policy and procedural direction rests not only with regional and district management, but with all subordinate supervisors as well.

(d) Studies of all ports which have work stations with the circumstances alluded to in b.(6), (7), (8), and (14) above, will be undertaken by regional and district management to determine the feasibility of establishing the mandated tours of duty at each location where applicable. A report of these studies, including a list of all work stations fitting the described circumstances, will be submitted to the Assistant Commissioner of Operations prior to September 1, 1979. This report shall include a detailed justification in instances where applicable tours of duty are not established. In addition, the report shall contain a summary of specific actions taken by the regions and districts to carry out the other provisions of this manual supplement.

4. OBLIGATIONS TO EXCLUSIVE REPRESENTATIVE:

(a) Existing NTEU Chapter Presidents shall be provided with copies of appropriate CF-6081's entitled "Register of Reimbursement Assignments" and CF-66-10's entitled "1911 Comparative Overtime Earnings Report" on a bi-weekly basis.

(b) Upon submission to the Assistant Commissioner of Operations, NTEU will be provided with copies of the study reports called for in Section 3(d).

(c) When such information becomes available, NTEU shall be informed of the anticipated impact of any new shifts on overall overtime earnings, hours of work, and number of overtime assignments of Inspectors.

(d) Where the implementation of this Manual Supplement results in the establishment of new shifts or other changes in matters affecting conditions of employment, NTEU shall be afforded the opportunity to negotiate over the implementation and/or impact of such changes. Such negotiations will be conducted at the Regional level, or, upon mutual agreement, at the District or local level as appropriate.

(e) The establishment of new shifts or tours of duty pursuant to this Manual Supplement shall be made in accordance with Manual Supplement 2132-03 of May 10, 1978, entitled "Assignment of Personnel to Inspectional Activities," and in accordance with applicable laws and regulations.

(f) The assignment of personnel to any new shifts or tours of duty established pursuant to this Manual Supplement shall be accomplished in accordance with applicable collective bargaining agreements and in a fair and equitable manner.

(g) Copies of this Manual Supplement will be distributed to all current inspectional personnel.

5. REPORTING ABUSES:

Any employee who wishes to report any abuses in the use of overtime by a fellow employee or supervisor may do so by, (a) submitting the complaint or report in writing to any supervisor or management official in his supervisory chain of command, or (b) utilizing the "hotline" provided for in the Manual Supplement to be issued entitled "Reporting Waste, Fraud, Program Mismanagement, Misconduct and Retaliation."

6. SUPERSEDED MATERIAL:

None.

7. EXPIRATION:

This Manual Supplement will expire upon incorporation into P&PM 2132.

R.E. Chasen

Commissioner of Customs

POST OF DUTY FOR INSPECTORS MAKING OVER
$40,000 PER YEAR -- FY 1979

POST OF DUTY	NUMBER
Montreal - preclearance	5
Toronto - preclearance	12
Bangor Maine	3
Gloucester Mass	2
Hartford Conn	1
Oswego NY	1
Kennedy Airport NY	50
Bermuda - preclearance	1
Newark NJ	1
Philadelphia PA	15
Chester PA	3
Wilmington DEL	3
Dover DEL	3
Pittsburg PA	5
Baltimore MD	1
Dulles Airport, VA	3
Charleston SC	8
Atlanta GA	7
Tampa FL	9
Jackonsville FL	1
San Juan PR	7

Miami FL		14
Nassau - preclearance		3
Freeport - preclearance	1	
Port Everglades FL	6	
West Palm Beach FL	3	
New Orleans L.a.	13	
Gramercy L.a.	6	
Baton Rouge L.a.	1	
Memphis TN	1	
Consolidated Port of Beaumont, Orange, Port Arthur, Sabine	2	
Corpus Christi TX	1	
Laredo TX	1	
San Antonio TX	8	
El Paso TX	1	
Houston Tx	8	
Dallas/FT Worth TX	5	
San Diego CA	2	
North Long Beach CA	2	
South Long Beach CA	2	
North Wilmington CA	1	
South Wilmington CA	3	
Terminal Island CA	1	
San Pedro CA	3	
Los Angeles CA	37	
Las Vegas NV	1	
San Francisco CA	9	
Portland OR	1	
Seattle WA	8	

Vancouver B.C. Canada	1
Tacoma WA	1
Anacortes WA	1
Anchorage AK	6
Honolulu HI	32
Galgary Alberta Canada	9
Minot ND	1
Minneapolis, St. Paul MN	1
Detroit MI	4
Cleveland OH	4
St Louis MO	2
	347

STAFFING OF THE COMMISSIONER'S OFFICE

Question: We understand that in 1976, the Office of the Commissioner had eight employees which included the Commissioner. Would you care to comment on how many employees are now in the Office of the Commissioner?

Answer: In FY 1976, the Office of the Commissioner had eight employees on the rolls, with an authorized staffing level of eleven. Presently, the Office of the Commissioner has nine employees on the rolls, with an authorized staffing level of nine.

Question: What is the employment status and connection of Fred Clark with Customs?

Answer: Mr. Clark is currently employed by the U.S. Customs Service as a consultant, providing advisory or consultant services to the Commissioner. He is working on an intermittent basis, not to exceed 130 days per year. His appointment was made in accordance with the Federal Personnel Manual, Supplement 831-1, Subchapter 515-7. This means that his salary, as a consultant, is reduced by the amount of his retirement annuity.

EXERCISE AREA

Question: You have closed your visitors center and converted the space to office use. How much is it costing you to construct your exercise area complete with showers and lockers?

Answer: Approximately $21,164.00 - construction consists of: lower ceilings and improved lighting in exercise room, renovate industrial space and convert into a women's shower/locker room (men's shower/locker room currently exists). Equipment requirements will be satisfied through surplus (reuse equipment from former U.S. Customs Service academy - closed September 1979).

BUDGET REDUCTION

Question: In light of $6.3 million cut in your latest budget request as compared with the Administration's original budget request for FY 1981, how would this cut affect your programs and operations? Are you going to be forced into reducing existing services?

Answer: The $6.3 million reduction would be taken as follows:

Activity	Pos.	Amount
Inspection and Control	9	$ 2,300,000
Tariff and Trade	20	1,428,000
Tactical Interdiction	30	1,851,000
Investigations	9	646,000
Executive Management	--	75,000
Total	68	$ 6,300,000

Our budget as originally submitted to the Congress provided for an overall reduction of 46 average positions. Since our budget reflected a decrease, a further decrease of $6.3 million will obviously require considerable belt tightening. However, in applying the reduction we have attempted to allocate it to those areas that would affect staffing the least and that would have the least impact to services to the public. As a result we have reduced only 68 positions. The major reductions will be in space and overtime. Also, we had not been recovering our costs on various fees for the entry and clearance of vessels and these fees have been increased accordingly. Due to these higher fees the reimbursements to our appropriation will be increased $1.5 million and we have applied this amount as an offset against our fiscal 1981 budget requirements.

AIR THREAT STUDY

Question: Does Customs have an open-ended contract with the Stanford Research Institute to measure the air threat of smuggling into the United States?

A. What is the amount of this contract?
B. How many bids were submitted for this contract?
C. Are you aware of two other Customs reports on this very subject?

Answer: The contract with SRI International has been completed. It was initially seen as a two phase study, but it was subsequently decided that efforts to collect more detailed data in Phase Two would not be feasible at this time; as a result, the contract was ended upon completion of Phase One. The amount of the contract was $296,279. No other bids were submitted for this contract since Customs determined that SRI International was the only organization among the several initially considered that met our selection criteria: possession of appropriate security and special intelligence clearances for access to anticipated domestic and foreign intelligence data of a sensitive nature, as well as an established relationship with designated intelligence agencies to be contacted during the study; no involvement in the prior threat studies for Customs, in order to ensure an objective analysis of these studies; experience in the utilization of long-range radar for aircraft detection and tracking and with the correlation of radar data and FAA flight plan data; being a not-for-profit organization without hardware commitments, in order to avoid conflicts of interest with other contractors regarding proprietary information or hardware development. Customs is aware of at least three other studies dealing with the air smuggling threat. One of these studies was done at the inception of the air program and is considered to be no longer descriptive of the present threat; the other studies were more recent, but dealt with threat estimates based on Customs data and using traditional means of threat estimation. Customs is aware of no other studies meeting the guidelines established for the SRI study, i.e., to consider data available from all Federal and other sources; to develop estimates based on innovative methods, for correlation with threat estimates presently available; and to consider the marine threat as well as smuggling by aircraft. Customs believed these guidelines were necessary to respond to the OMB request for an independent and current air threat study.

LIQUOR SEIZURES

Question: Would you please tell the Committee what you do with the liquor you seize? How do you dispose of it and is any of it used by any Federal agency or private concern?

Answer: Alcoholic beverages in seizures of (5) gallons or more, are reported to the General Services Administration for disposal Alcoholic beverages reported for and which are not authorized by GSA for transfer to another Federal agency for official use or to an eleemosynary institution, are sold at public auction.

Alcoholic seizures of 5 gallons or less may be donated to a known eligible charitable institution without prior screening by GSA. If such quantities are not donated, they are sold at public auctions providing that the quantities and/or value justify the expense of sale. If not, they are destroyed.

Forfeited alcoholic beverages not fit for human consumption, scientific or medicinal purposes, are immediately destroyed.

INTENSIVE INSPECTION OF SHIPMENTS

Question: The General Accounting Office recently recommended that Customs develop an intensive inspection of shipments selected on a scientific random basis rather than just a cursory examination of most shipments. What are you doing to carry out that GAO recommendation?

Answer: In response to both the recommendation of the General Accounting Office and continuing interest by OMB, Customs has, for the past year, been developing a compliance measurement system for cargo shipments.

Customs Compliance Measurement (Cargo) is a systematic method for determining the degree to which importers conform with Customs regulations, administrative decisions, legal precedents and other agency requirements. Compliance measurement makes use of scientific sampling, intensified processing and statistical analysis techniques. Compliance characteristics are measured on a universe (in this case imported cargo) under normal processing, and on a selected sample under intensified processing. The results are then compared, analyzed and used to generate appropriate quantitative findings in order to meet Customs goals.

An initial field test of CCMP-Cargo is scheduled to begin in the port of Philadelphia this summer and will last from six to eight months. Approximately 1,000 entry line items will be sampled. Each sampled shipment will be subjected to a very intensive physical examination by Customs Inspectors and a thorough entry documentation review by Import Specialists. The results of this intensive processing will be carefully documented and compared with the documented compliance results of normal processing to derive compliance levels and "gaps."

FREEDOM OF INFORMATION ACT

Question: Has the Freedom of Information Act presented Customs with any serious problems? In other words, have criminal conspirators been able to request information not only on themselves but on cohorts who can be spotted as informants if they do not have a file?

Answer: In our responses to FOIA requests for law enforcement case files, we are very careful to protect the identities of informants and cooperating invidivuals. However, when dealing with voluminous records, involving criminal conspiracies, there is always the risk of unintentionally releasing sensitive information which may not be easily recognizable as such to the case reviewers, but may provide meaningful clues to the FOIA requester who was involved in the criminal activity.

The law does not allow the blanket withholding of criminal investigative files and each withholding or deletion from a record must be justified specifically, and if challenged in court, supported by lengthy affidavits. Adding to the problem is the requirement of the Act to respond to requests within 10 working days or face the possibility of a law suit. In other words, the time prescribed by the Act to respond is frequently insufficient to permit a thorough review of voluminous case files.

Equally significant is our concern that the disclosure requirements of the Freedom of Information Act will, in the long run, adversely affect the information gathering ability of the agency in the area of value investigations by our investigators in foreign countries. Information concerning the valuation of imported merchandise has traditionally been obtained from foreign manufacturers with the tacit understanding that information voluntarily supplied would be held in confidence. General awareness of the Government's inability to guarantee confidential treatment is believed to inhibit full cooperation in supplying sensitive commercial information because of fear of possible disclosure.

QUESTION: Tell us about your problems with the legal restrictions imposed by the Attorney General's procedures relative to Executive Order 11905.

ANSWER: It is difficult for Customs to accurately gauge the loss of intelligence due to the restrictions imposed on the Foreign Intelligence Agencies by E.O. 12036 (which superceded E.O. 11905 in January 1978). At the time Customs was merely in the process of establishing working relationships with those agencies when the "wall" came down in the mid-seventies; we thus have little in the way of past performance which can be used to measure its impact. Secondly, we do not have the capability to separate the impact of E.O. 12036 from other factors which may impact: technical limitations, resources competition, and other legal problems. Nevertheless, we should like to offer a few comments and observations.

Although relations between the Foreign Intelligence Agencies and the Enforcement Agencies have improved considerably since the mid-seventies, the fact remains that Customs receives very little information from those agencies which could be of use in fulfilling its mission. Under E.O. 12036, there are only two areas of concern to Customs which are clearly defined as legitimate foreign intelligence subjects: international narcotics trafficking and international terrorism. Other areas, such as Currency and Neutrality violations, are less well defined and encounter greater difficulties. And even activities within the two designated areas are subject to other restrictions within E.O. 12036, such as those regarding U.S. persons and foreign communications destined for receipt in the U.S. The effect of these restrictions is to limit the types of information which the Foreign Intelligence Agencies may intentionally collect overseas.

A second problem relates, not to collection, but to distribution to law enforcement agencies of information which has been already gathered. The difficulty here is the threat of disclosure of sensitive sources and methods in the course of judicial proceedings following an arrest. Although not directly related to E.O. 12036, this problem is as serious as the collection limitations. The Foreign Intelligence Agencies are reluctant to distribute to enforcement agencies information -- whether intentionally gathered or collected by accident -- which is directly actionable and likely to lead to arrest and prosecution. Further discussion of this subject, however, is difficult in an open forum because of security classifications.

As to the dissemination of intelligence to other enforcement agencies, there are two main hurdles: the classification of the information and the threat of disclosure. Unless Customs acquires an unclassification version of specific information, it cannot be used tactically. In addition, the Foreign Intelligence Agencies do not desire widespread dissemination of information that is likely to compound the disclosure difficulties (e.g., to state or local authorities.) As is usually the case when classified information is received from a Foreign Intelligence Agency, Customs cannot make any further distribution without the approval of the originating agency.

There is no doubt that the legal problems discussed above are a reflection of the basic tenets of our legal system and our democratic form of government. But we also feel that such concerns must always be weighed against other, sometimes competing concerns of the nation. In order for Customs to fulfill its mission, it must know where to look in the immense volume of goods and people that flow into our country every day. Knowledge of what is happening outside our borders would be of immeasurable assistance to us in this effort, but we feel that much is being denied us because of the lack of "balance" in the restrictions and limitations discussed above.

Question: Reorganization Plan #2 designated DEA as the sole agency responsible for narcotics intelligence investigations. In carrying out its mission DEA concentrates on successful prosecution and therefore tends to focus on case related intelligence. Since the implementation of Reorganization Plan #2 have you failed to receive intelligence supportive of your interdiction mission, particularly with respect to Mexico and the Caribbean which are major sources and transit areas for narcotics and marijuana?

Answer: With the implementation of reorganization Plan No. 2 on July 1, 1973 the Customs authority to investigate controlled substance violations and to act as a primary agency for collection of narcotics related intelligence in foreign areas was transferred to the newly formed Drug Enforcement Administration (DEA). It was soon recognized that reduction in available intelligence had an adverse impact upon the Custom narcotics enforcement effort. To counter this adverse impact, Customs and DEA entered into negotiations to clarify the role of each agency in the national drug enforcement effort. On December 19, 1975, the Commissioner of Customs and the Administrator of DEA jointly issued a Memorandum of Understanding which clarified the relationship and responsibility between the two agencies. The Memorandum reaffirmed Customs as the agency with primary responsibility for interdiction of all contraband, including drugs, at land, sea, and air borders of the United States, while DEA has the primary responsibility for investigation and intelligence gathering related to drug smuggling and trafficking. Each agency agreed to expeditously furnish drug related smuggling intelligence to the other.

In an attempt to increase the flow of intelligence from DEA, Customs established representation in the EL Paso Intelligence Center (EPIC) in April 1976 and has since increased its personnel commitment to 12 permanent positions. In addition, during April 1976 Customs detailed an Intelligence Specialist to DEA Headquarters and has maintained continuous representation within the DEA Office of Intelligence since that time. As a reciprocal measure DEA detailed a representative to the Customs intelligence component in January 1980. Customs and DEA conduct almost constant evaluation of the exchange of enforcement data and are constantly seeking methods to improve both the quality and quantity of intelligence available with regard to the narcotic enforcement effort.

At the beginning of FY 79, Customs established an objective of increase enforcement effectiveness particularity with regard to cocaine from Colombia. This effort was identified as the Narcotics Intelligence Priority (NIP) program and was expanded to a task force consisting of Customs, DEA Headquarters and EPIC. During the course of the program, Customs representatives traveled to Colombia to brief in-country DEA officials regarding NIP and to establish more effective channels for the exchange of intelligence pertinent to the project. A formalized spot requirement procedure was also developed in order to establish a method to levy intelligence requirements for near real-time collection and reporting. Intelligence developed through the procedures established for NIP was confirmed in several instances, one in which 3 1/2 kilograms of cocaine were received and in another involving the crash of an aircraft which was estimated as carrying 60 kilograms of cocaine, 900 pounds of marijuana, and a large quantity of pills. While the formal NIP program concluded at the end of FY 79, procedures developed during the program are continuing.

During the past several years, numerous special enforcement efforts have been targetted against the illicit traffic from South America which passes through the Caribbean and enters the southeastern U.S. Operation names such as GULFNET, BULLRING, STOPGAP; SNOWBIRD, and BOOMER FALCON are familiar to Customs, DEA and Coast Guard personnel who are assigned in that area since each of the operations was a joint effort involving all of the above services with much of the coordination being accomplished through EPIC. Other cooperative efforts are non-operational such as the publication of reference materials for use by enforcement officers and intelligence collectors. One example of such a product is the "Vessel Identification Handbook" which was a joint effort of Customs, Coast Guard, DEA and EPIC.

The Drug Enforcement Administration acts as the "eyes and ears" in the Caribbean and Mexico as in all major drug source and transshipment areas. Several of the DEA/Customs projects, while directed toward Colombia have raised the quality of overall intelligence reporting through an increased awareness of Customs needs.

Question: I understand you have some new petroleum import procedures and regulations. Would you please tell the Committee how the new measure will work and assess the reliability?

Answer: Customs has developed new regulations regarding imported oil and they are in final review at the Department of Treasury and are expected for publication in the next few weeks. Essentially, the amendments to our present regulations increase Customs involvement in import transactions and strengthen our control and our ability to reliably report import statistics. The new regulations provide three essential changes. Firstly, they make importing carriers strictly accountable for manifesting imported quantities of oil. Secondly, they increase Customs physical involvement by providing for two measures of the oil and by reducing the use of public gauger reports. Customs will be a part of every import transaction and will take a measure of all oil. Lastly, the controls on and accountability of public gaugers has been increased. There are still limited times when Customs will accept public gauger reports; namely for one measurement, when Customs has independently taken a second. However, the requirement on public gaugers has not been increased in terms of penalty procedures.

In conjunction with the newly proposed regulations, Customs has developed internal operating procedures to implement the regulations. These procedures stress control and strict adherence to Customs requirements.

Also in conjunction with Customs increased involvement in imported oil, we have developed a national training course in the technical art of oil measurement and we have developed an automated system for oil import licenses, which we maintain for the Department of Energy. This system is due to begin July 1, 1980. We are also working closely with other agencies to assure the Congress, the White House, and the public that the Customs Service is maintaining proper controls of and accurately reporting about this very critical area of imported petroleum and petroleum products.

Question: During this time of necessary austerity, we are concerned that Customs coverage at international airports be provided at an appropriate level. It is important that the travelling public not be severely inconvenienced, yet this must be done at a reasonable cost to the Government. I am particularly concerned that Customs provide inspectors at ports-of-entry on regular duty shifts based on scheduled arrivals in order to avoid unnecessary overtime costs. Since the airlines must make the maximum use out of their equipment as well as meet noise and operating curfews in countries throughout the world, it would be unrealistic for us to ask them to change their schedules to meet a 9-5 (or other arbitrary) shift worked by Customs inspectors. Would you outline what steps have been taken to insure that Customs inspectors have duty hours which coincide with the schedules of the international airlines, and what future plans exist for changing shifts to avoid overtime?

Answer: In the past, significant overtime was performed immediately before and after the official hours of some ports. We have been establishing new shifts and rearranging existing shifts to cover these services based on instructions issued on June 12, 1979. We will, in accordance with these instructions and section 101.6, Customs Regulations, which provides for extending Customs Service outside official hours to locations when there is a regular recurring need for same, continue to establish new shifts where Customs officers can be gainfully occupied for a shift.

Question: Is there anything Customs could do at the present time with the air resources on hand to increase its overall effectiveness? Are on-hand resources presently assigned to the most productive or potentially most productive geographic areas? In what parts of the country are the most air cases being made at this time? Are adequate on-hand resources assigned to those areas of greatest threat?

Answer: In terms of numbers of aircraft very little. Some personnel shifting from the Southwest to the Southeast United States could potentially increase overall output. Region IV (Miami) is now developing a plan to make permanent some features of the BOOMER/FALCON OPERATION and will identify their personnel requirements in this regard.

The resources of the program are spread over the Southern border of the United States to provide some interdiction potential for the length of the border and provide enforcement support to Customs and other law enforcement entities, however, the Southeast United States has received additional manpower and equipment including the most effective aircraft in the fleet, a Citation II interceptor. A second Citation interceptor will also be assigned to the Southeast in May 1980.

The Southeast United States is the most productive area at this time.

The numbers of aircraft assigned to the Southeast United States are adequate. However, most of the aircraft on-hand, fleet-wide, are not equipped with effective sensors for the interdiction mission.

QUESTION: Commissioner Chasen, do you foresee the situation in Iran resulting in an increase of drugs flowing from that country? As you remember the Shah was quite successful in reducing Iran's drug exports.

ANSWER: The amount of Southwest Asian heroin entering the West Europe markets since 1975 has risen dramatically. Immediately following the disruption of the "French Connection" in the early 1970's there was virtually no Southwest Asian heroin available in West Europe or the U.S. Southeast Asian heroin quickly filled this void. However, by 1978, 25 percent of all heroin seized in West Europe was Southwest Asian, and by 1980, Southwest Asian heroin may now account for the majority of all heroin found in Europe. The amount of Southwest Asian heroin that is estimated to be reaching the United States has doubled (from 17 to 35 percent of the illicit U.S. heroin market) between 1978 and 1979.

The political situation in Iran remains unstable with no effective police force counting the expanding opium production and trafficking operations. However, with no DEA or State Department officials in Iran in a position to detect the full extent of the opium problem, the impact upon Europe and the U.S. can only be estimated. Iran is second only to Pakistan in the amount of opium cultivated on an annual basis. In 1979, it is estimated that Iran produced 600 tons of raw opium compared to 160 tons produced in the Golden Triangle of Southeast Asia and 10 tons in Mexico. Iran - produced opium/heroin is currently the primary threat to the U.S. from Southwest Asia. The opium is being converted to heroin either in labs located in Eastern Turkey, or in Iran itself. Most of the Iranian heroin is being transported to the U.S. direct from Southwest Asia rather than using stash sites in Europe. The one exception to this general routing pattern may be the use of Italy as a transshipment location.

Southwest Asian heroin presently accounts for approximately one-third of all illicit heroin in the United States. For the first time since the end of the French Connection, Mexico does not account for a majority of the U.S. heroin market. Each of the three basic types of heroin (Southwest Asian, Southeast Asian and Mexican) accounts for approximately one-third of the U.S. market, according to DEA. As recently as the end of 1978, Southwest Asian heroin accounted for only 17% of the U.S. market, however, its percentage has almost doubled in slightly over one year. This is especially significant when one realizes that, to date, there are only limited organized efforts to import Southwest Asian heroin into the U.S. Currently, most traffickers of this narcotics are small entrepreneurs who do not have an organization behind them, and who, for the most part, have no contacts with the necessary distribution networks in this country.

In summation, with the vast amount of opium produced in the Southwest Asia area (1600 tons vs. a total of 170 tons in Mexico and Southeast Asia), it is a certainty that the U.S. will be hard hit by the increase. At present, the organizational ties between the opium producing area and the U.S. marketplace are proving difficult to establish, and the average courier remains a relatively unsophisticated individual. However, an honest assessment must take into account that the Southwest Asian heroin variety is currently the cheapest and purist on the market, and the organized crime networks in the U.S. will be moving to capitalize upon this source, particularly with the downturn in Southeast Asian and Mexican supplies. The greatest smuggling threat to the Customs Service will be through the international airports. All international airports, including preclearance facilities, are susceptible to Southwest Asian heroin smuggling.

Question: What organizational difficulties exist between Federal Law Enforcement Agencies which dilute our efforts to stop the entrance of drugs into this country at our borders?

Answer: In the past three years there has been significant improvement in the cooperation among the border enforcement agencies: Customs, DEA, Coast Guard, and INS. Much of the improved effectiveness against smuggling results directly from the sharing of intelligence and the joint operations encompassing all of the involved agencies. Organizational problems and difficulties which formerly characterized border enforcement are minimal and, we believe, do not impact the effectiveness of the interdiction effort.

Question: In 1977, GAO recommended that the Congress require the Executive Branch to develop a comprehensive border control plan. What has been done?

Answer: Although there is no formal border control plan, the involved agencies - Customs, Coast Guard, DEA, and INS - under the general direction of the Domestic Policy Staff and the advisory Principals Group, which includes all of the agencies, are operating under a comprehensive policy to stop drug smuggling along the nations borders. Under this system, the agencies have increased cooperation and have produced a more integrated effort along the entire border. Sharing of intelligence and joint operations has greatly strengthened the effectiveness of border interdiction. An excellent example of these efforts is provided by the joint operations along the Southeast border. The involved agencies are directing their resources and units to those missions to which they are most suited. Duplication of effort and conflicting jurisdictions are minimized. In terms of drugs and currency intercepted, the results have been outstanding.

LEGISLATION TO TAKE AWAY THE FINANCIAL RESOURCES OF NARCOTIC TRAFFICKERS

QUESTION: Even though numerous high level traffickers have been convicted, their organizations continue to operate and maintain distribution capacity. Would you recommend additional legislation to take away the financial resources of major traffickers?

ANSWER: Existing law provides certain means by which the financial resources of drug traffickers can be reached. The Customs Service has the primary responsibility for the enforcement of that section of the Currency and Foreign Transactions Reporting Act which requires individuals who physically transport, mail, or ship, or cause to be physically transported, mailed or shipped, more than $5,000 in currency or bearer monetary instruments upon entering or departing the United States to file a report (Report of International Transportation of Currency or Monetary Instruments) with Customs. While we have found the Act to be useful against drug traffickers, as well as other international organized crime ventures, the Act does have certain deficiencies that restrict its effectiveness.

Presently, there are two measures which have been introduced in the Congress that would remedy the major deficiencies by providing (1) that it is illegal to attempt to export or import currency or other monetary instruments without filing the required reports, (2) that Customs officers be authorized to search suspected individuals at the border for currency or other monetary instruments without a search warrant when they have reasonable cause to suspect or believe that individuals are importing or exporting currency which must be reported, and (3) that a reward may be paid for information leading to a recovery under the Act (S.2236 and H.R.5961 - bills to amend the Currency and Foreign Transactions Reporting Act). Your full support of these provisions would give Customs the tools needed to enforce the Act effectively and therefore enable us to attack and take away the financial resources of major drug traffickers.

Customs also believes that it would be assisted in meeting the objectives intended by Congress (to frustrate and immobilize the international movement of illicit funds for criminal purposes), if Title III of the Omnibus Crime Control and Safe Streets Act of 1968 (P.L. 90-351) included violations of the Currency and Foreign Transactions Reporting Act. Specifically, Title 18 USC 2516(1), which authorizes the interception of wire or oral communications, under court order, for such offenses as narcotics and dangerous drugs violations and other crimes including theft from interstate shipments, extortionate credit transactions, bankruptcy fraud, conterfeiting, bribery of public officials, interstate and foreign travel or transportation in aid of racketeering enterprises, etc., could be amended by adding the following:

> Any offense involving the transportation of currency or monetary instruments into or out of the United States in violation of Section 1101 of Title 31 of the United States Code (relating to the enforcement of the Bank Secrecy Act), punishable under Section 1059 of this Title.

Question: Have the bail and sentencing practices in Federal court diluted the effect on your drug interdiction efforts?

A. Has Customs been victimized by revolving door justice wherein you arrest a trafficker and he is immediately released on bail?

Answer: At the present time, the prosecutorial responsibilities for violations of the Comprehensive Drug Abuse Prevention and Control Act are vested in the Drug Enforcement Administration. Therefore on a day-to-day basis DEA and the Department of Justice will be most familiar with bail and sentencing practices in the federal district court. In our opinion the federal drug enforcement effort has been made more difficult. However, since we are not the agency most familiar with bail and sentencing practices we are unable to ascertain whether these practices are responsible for the greater difficulty encountered in the drug interdiction effort.

SOUTHWEST BORDER TRAFFICKERS

Question: How do you respond to the allegation that the Southwest border apprehensions seldom involve high level traffickers?

Answer: The Customs mission is limited to interdiction at or near the border. High level traffickers are seldom if ever personally involved in smuggling activities in the border area. In accordance with Reorganization Plan #2 investigations leading to the apprehension and prosecution of high level traffickers is the responsibility of DEA.

COAST GUARD SEA INTERDICTION

Question: Now that the Coast Guard is cutting back its sea interdiction activities, what action do you intend to take to fill the void which lessened capability will create?

Answer: We will further reduce random marine patrol and will concentrate our efforts instead on improving our enforcement information gathering capability. This will result in improved intelligence permitting us to more efficiently respond to marine smuggling activities. We are also developing a more sophisticated strategic intelligence capability in the Customs Service. The more accurate threat identification resulting from this capability will assist us in making decisions concerning the redeployment of existing resources.

EIGHT-HOUR SHIFT

Question: What is the reason most air branches went to one eight-hour shift per day? Is this due to lack of pilots? What action do you intend to take to increase the numbers of pilots and to improve their morale? What funding is necessary to supply an adequate number of pilots? How many pilots are needed?

Answer: Some air branches establish single shift operations for the following reasons: Branches that have poor radar coverage or detection resources utilize intelligence collection techniques to identify and detect smugglers. These branches will establish a single shift operation, but will react and work other hours and days on a case by case basis, as required.

Branches that have radar/detection resources may have to concentrate their manpower in a selected eight-hour period each day to staff radars and interceptor aircraft to an effective level. However, the lack of pilots and air officers is the major limiting factor in expanding hours of scheduled operation.

A revamped air strategy will be tested for effectiveness this year. Upon the demonstrated validity of the new program the first module will be emplaced with the staff necessary to conduct its operation.

Morale should be enhanced by; (1) a specialized national training program to enhance professional capabilities and increase performance effectiveness. (2) A standard operating procedures manual to unify the program. (3) The perception that new initiatives will be taken from the program study recently completed to increase operation effectiveness and provide achievable results.

The required additional operational staffing to fully implement the revamped strategy is 82 personnel (pilots and air officers) at an approximate additional cost of $2.99 million per annum. However, this strategy is yet to be validated to ensure that additional personnel will provide major increases in output.

AIR BRANCH

Question: Have air branch units acquired enough planes to begin to do an adequate job in the Air Interdiction Program?

Answer: To date the Air Program's fleet of aircraft has reached an adequate level in terms of numbers. The addition of 5 turboprop, 2 fan jet and 4 turbojet aircraft have substantially increased our average speed and platform capability.

However, the 5 turboprop lack sensors limiting their usefulness for night operations. The 4 turbojets are radar equipped, but old (20 yrs.), difficult to maintain and very costly to operate. The remainder of our sensor equipped aircraft, i.e. S-2's and OV-1's are all military surplused equipment resulting in the unavailability of parts and high operating costs. These aircraft are not cost efficient and will be surplused when other aircraft are available to replace them. In order for the Air Program to effectively interdict contraband laden aircraft the number of effective sensor equipped platforms must be increased.

Question: Are the present planes in the air branches the appropriate planes for the job? If not, why not?

Answer: The present aircraft inventory is generally appropriate to address the air support mission. However, there are an insufficient numbers of appropriate aircraft for the air interdiction mission.

The Service has been limited by budget constraints in its efforts to acquire suitable aircraft by purchase. Equipment was largely supplied by military surplus/excess equipment and through forfeiture of seized aircraft. The early air situation was characterized by accepting inefficient aircraft rather than have none at all.

Question: Why hasn't appropriate sensor gear or radar been provided for the planes so that night operations can be efficiently carried out?

Answer: The program requires radar capability whose technology is state-of-the-art and not previously available, affordable, or which requires extensive applications engineering/modifications to be of use. The F-16 radar modification to the Citation intercepter is an example of these efforts, which has proven highly successful. Although FLIR equipment (night vision) is available the Service is reluctant to modify aging or unsuitable aircraft with this equipment. Only recently has the arrival of five turboprop aircraft provided a suitable platform. The first aircraft will be modified with FLIR this August provided funds are available. Additionally, the military are developing a lighter-weight and lower-cost infrared system that would be a very appropriate sensor for Customs, but their present development schedule indicates these systems would not be available until 1983-1984.

Question: How much money is needed to equip all the King-Air 200's with equipment to expand their effectiveness into night operations?

Answer: $8.3 million is estimated for this effort to include Research and Development and modification costs.

FOUR AIRCRAFT

Question: Why was your original request for four aircraft in FY 1981 deleted from the revised budget request?

Answer: There was no request for additional aircraft made by the Customs Service in the FY 1981 budget process.

COMMUNICATIONS EQUIPMENT

Question: In your reqport submitted to this Committee you state "Customs already is equipped with a fairly good assortment of communications equipment, including HF, UHF, VHF, etc. capability." How does this fit in with the inability to communicate with AWACS planes?

Answer: We are unaware of any major difficulties communicating with AWACS aircraft.

In areas where the air support branch (ASB) is not equipped with HF radio and the AWACS aircraft is too far from the ASB, communication between the ASB and AWACS aircraft has to be relayed via Sector Radio. This has caused some coordination problems.

Presently most of our ASB's are equipped with HF radios. The two ASB's without HF radios, San Antonio and San Diego, are planned to receive HF sets in the near future.

MEXICO

Question: Are you conducting discussions with the State Department with respect to gaining the authority to perform overflights into Mexico?

Answer: No

NEW INTERDICTION TECHNOLOGY

Question: What new technology has been applied in the last year by the Customs Service to help the interdiction program capability apart from the acquisition of the Citation II's?

Answer: In FY-79 and early FY-80 Customs has carried out several new technology projects in support of the air interdiction program. To aid in aircraft detection and tracking we installed a second Unattended Border Alert Surveillance System (UBASS) and ordered a third system; we distributed about fifty new types of aircraft tagging devices that were built either by Customs or our contractors; we improved our present airborne direction-finding-systems; and we built and tested a feasibility model of a low-flying aircraft detection system. To support our use of either FAA, Air Force or Customs radars we begin field testing of new mobile surveillance radars; we installed the first prototype of the Radar Integrated Display System (RIDS), which will enable us to establish radar command and control centers at our Air Support Branches; we continued development of our automated system for recording and analyzing radar track data, including data provided by AWACS; and we began the first test of the radars excessed by the Air Force as a fixed-site gapfiller radar. In addition, we acquired from the Environmental Protection Agency two of their aerial camera systems which we now are using to photograph suspect landing strips hidden in otherwise unaccessible areas, and we have ordered our first ground sensor system specifically designed to monitor remote airfields suspected of being used by smugglers. Finally, we are continuing the development of a hand-held device which we believe can be used to rapidly examine general aviation aircraft for the presence of concealed hard drugs and other contraband. The variety of these various efforts is an indication of the many different aspects and requirements of air interdiction that must be pursued by Customs in addition to the acquisition of adequate aircraft and airborne sensors.

ADDITIONAL RESOURCES

Question: What additional resources were committed last year to stablize and improve the Air Program?

Answer: The following additional resources have been committed:

Four (4) T-39 (Sabreliner) Turbojet, modified with an Emerson radio for tracking aircraft were acquired from the military for use as interceptors.

One VLF long-range navigation system, suitable for off-shore search and surveillance was acquired.

Other resources committed to the Air Program are discussed in the previous question regarding new technology applied to the Air Interdiction Program.

BUREAU OF GOVERNMENT FINANCIAL OPERATIONS

STATEMENT OF PAUL TAYLOR, FISCAL ASSISTANT SECRETARY, DEPARTMENT OF THE TREASURY

ACCOMPANIED BY:

GERALD MURPHY, ACTING COMMISSIONER

MICHAEL D. SERLIN, ASSISTANT COMMISSIONER, DISBURSEMENT AND CLAIMS

WALTER L. JORDAN, ASSISTANT COMPTROLLER FOR FINANCE

ARTHUR D. KALLEN, DIRECTOR, OFFICE OF BUDGET AND PROGRAM ANALYSIS, DEPARTMENT OF THE TREASURY

BUDGET REQUEST

Senator CHILES. The committee will now receive testimony from the Bureau of Government Financial Operations regarding the fiscal year 1981 budget request and the fiscal year 1980 supplemental request. For fiscal year 1981 $188,012,000 and 2,465 permanent positions have been requested; $2 million has been requested for the fiscal year 1980 supplemental.

The committee is pleased to have Mr. Gerald Murphy, the Acting Commissioner, and Mr. Paul Taylor, the Fiscal Assistant Secretary, to submit testimony in support of these requests.

Mr. Murphy and Mr. Taylor, we will insert your full statement in the record. We would be pleased if you gave us a brief summary of your statements.

Mr. TAYLOR. My statement is very brief, Mr. Chairman. I am pleased to be here and to have this opportunity to provide opening remarks on the fiscal year 1981 appropriations request of the operating bureaus of the Fiscal Service.

With me are Mr. Gerald Murphy, Acting Commissioner of the Bureau of Government Financial Operations; Mr. H. J. Hintgen, Commissioner of the Bureau of the Public Debt; and from the Department Mr. Arthur Kallen, Director, Office of Budget and Program Analysis. Messrs. Murphy and Hintgen will introduce the individuals accompanying them.

As is the case for a number of Treasury functions, the programs of the Fiscal Service are largely service related and determined by factors in the public sector and the program agencies of the Government. This, of course, is the critical element in our budget/appropriations process since we have relatively little control over our workload. To keep costs down, we must continually look for better and more efficient delivery systems for our financial operations.

For example, were we to rely solely on Treasury checks in our disbursing operation, our peak-period production cycles at the beginning of each month would be now reaching a state where not only our productive capacity would be strained but the facilities of the Postal Service and the banking community as well.

As it is, our highly efficient direct deposit/electronic funds transfer payments system will replace some 149 million checks in 1981 with direct magnetic tape transfers between our disbursing offices and payee bank accounts—through the facilities of the Federal Reserve. For each of these payments, the expense of mailing and handling a check has been avoided. For every check issuance eliminated about 12 cents is saved. At the present level, that equates to annual savings of over $14 million.

Our long-range goals are to have 55 percent of all eligible payments included in the program by 1985 and 80 percent by 1990. To reach these goals, we are continuing to work with Federal agencies, the Federal Reserve, the financial community, and the payment recipients. I should add that this program is strictly voluntary. It depends a good deal on us selling the program.

Similarly, the book-entry system for Treasury securities has eliminated definitive engraved securities for approximately 93 percent of all outstanding marketable Treasury debt.

Despite these technological advances, workloads in some cases because of unanticipated circumstances have hammered at us relentlessly. In other areas, innovations from which we expected heightened productivity have not brought us the relief expected. I realize that the subcommittee is concerned about these areas—and let me assure you that every level of Treasury management is working diligently toward their resolution. I will discuss these areas in somewhat more detail.

The Bureau of the Public Debt is presently beset with extremely serious operational difficulties which are directly attributable to the abnormally high interest rates which prevail.

The Bureau workload in marketable Treasury securities, particularly with respect to Treasury bills, expanded dramatically and unexpectedly during 1978 and 1979 and continues to grow. The number of book-entry Treasury bill accounts maintained by the Bureau is 393,000, more than 400 percent higher than 1 year ago.

In the past year, the number of accounts for registered Treasury bonds and notes has increased by nearly 24 percent, from 485,000 to 604,000. These unforeseen developments have necessitated extraordinary internal adjustments and innovative measures. For example, the Bureau is currently concluding negotiations to acquire outside data processing services which are expected to provide some relief and enable the Bureau to continue providing appropriate service to individual Treasury bill purchasers.

As interest rates began to climb to record levels, a process of disintermediation began with respect to U. S. savings bonds. Savings bond holders began redeeming their bonds and looking for alternative investments with higher yields. Redemptions began to rise significantly late in 1978 and are now at the highest level in the history of the savings bond program. In the first 6 months of fiscal year 1980, redemptions were 49 percent higher in terms of the number of bonds and 84 percent higher in terms of dollars than in the corresponding period of fiscal year 1979. This abnormal level of activity shows no signs of abating.

The heavy redemptions of savings bonds impact the Bureau in three ways. First, there is the workload involved in processing redemptions. Second, there is a resource problem related to the payment of fees to the agents who accept savings bonds for redemptions throughout the country. Third, it appears that a significant portion of funds previously invested in savings bonds are being redirected to the purchase of Treasury bills, which augments the workload in that area.

We are actively concerned with this situation on a day-to-day basis and we are continuing to explore all feasible options for dealing with the workload demands within the limits of available resources.

The Department is deeply concerned about the problems that surfaced during fiscal year 1979 which have impacted and reduced the effectiveness of the Bureau of Government Financial Operations' check claims program. We are also deeply committed to seeing that these problems are solved both in their short and long range aspects.

Between 1977 and 1978, the Bureau significantly improved the timeliness of replacing lost or stolen checks for the public. By the end of 1978 a new system intended to accelerate the receipt of payment information reaching Treasury had been installed. This system involved the truncating of over 700 million checks at the processing Federal Reserve Banks and forwarding the related tape and microfilm information to Treasury here in Washington. Startup problems with this system combined with inefficient manual and outdated computer systems in the Bureau resulted in major increases in account receivable balances and significant buildups in backlogs which had been slowly growing for several years.

Since the summer of 1979, the attention of top management in the Department as well as the Bureau has been focused on resolving the problems in the Division of Check Claims. To this end, a Departmental Oversight Group has been working to help the Bureau develop management objectives and plan short-range solutions designed to reduce backlogs and accounts receivable balances while laying the groundwork for longer range and more permanent solutions. The Oversight Group's interim status report should be ready by the end of this month.

Short-term actions include an automated system for accounts receivable processing. Important features of the system are accounts receivable aging and work volume information to allow early warning of backlogging situations. This system is now operational for double payments and we expect the first monthly reports in early May. Also, the Division is engaged in a major effort to redesign and simplify workflow and paperwork. The redesign has been undertaken by key managers and other employees under the guidance of a skilled management consultant who has installed similar successful programs in the Government.

Along with these systems changes, a major recruitment effort is underway with departmental oversight to bring in qualified professional and managerial talent to keep operations current and assist in eliminating the crucial systemic problems.

The major long-range objective is the redesign of the Check Payment and Reconciliation System. This will take several years but will provide improved efficiency for the Bureau as a whole and will eliminate limitations in the current system which have hampered improved efficiency in the claims area.

I hope that this brief background will give you additional perspective in your review of the appropriations request for the operating bureaus and that you will appreciate the relatively uncontrollable nature of the bureaus' workload and the austerity of the requests in that light.

Mr. Murphy will now provide greater detail on the programs of the Bureau of Government Financial Operations. Following him, Mr. Hintgen will report on the activities of the Bureau of the Public Debt.

Senator CHILES. Mr. Murphy, we will put your statement in full in the record. If you could summarize and give us some brief highlights, if you want to, because our time is really running away from us. We will only have a few minutes to ask you some questions.

Mr. MURPHY. I would be happy to, Mr. Chairman. I will just briefly summarize the prepared statement.

The Bureau of Government Financial Operations is responsible for providing disbursing and claims services for most Government agencies, for maintaining the Government's central summary accounts from which we prepare and publish a number of periodic and special reports on the financial operations of the entire Government, for providing leadership and guidance in promoting sound and effective cash management practices by Government agencies, and for other unique central fiscal operations.

In short, our function is to provide services to Federal agencies and the public; and, as you know, the quantity of services we are required to perform increases each year.

To carry out our responsibilities during fiscal year 1981, we request an appropriation of $188,012,000. This is a decrease of $2,349,000 below our authorized level for fiscal year 1980, despite price increases and higher service levels. Therefore, our request this year is quite lean and austere.

In terms of resource requirements, postage continues to consume the predominant portion of our funds. This largely uncontrollable expenditure will reach a level of $76 million in 1981, roughly 40 percent of the entire appropriation, but only $154,000 higher than in 1980.

Employee services in 1981 are estimated at 2,696 average positions for a total cost of $50 million, including all fringe benefits.

PREPARED STATEMENT

Senator CHILES. Mr. Murphy, we have read your statement. I think we have a summary of it. We are going to have to proceed by putting the rest of it in the record so we will have time for questions.

[The statement follows:]

STATEMENT OF GERALD MURPHY

GENERAL STATEMENT

Mr. Chairman and Members of the Committee, it is a pleasure for me to appear before you today.

The Bureau of Government Financial Operations is responsible for providing disbursing and claims services for most agencies of the Federal Government; for maintaining the Government's central summary accounts from which we prepare and publish a number of periodic and special reports on the financial operations of the entire Government; for providing leadership and guidance in promoting sound and effective cash management practices by Government agencies and, for other unique central fiscal operations. In short, our function is to provide services to Federal agencies and the public and, as you know, the quantity of services we are required to perform increases each year.

To carry out our responsibilities during fiscal year 1981, we request an appropriation of $188,012,000. This is a decrease of $2,349,000 below our authorized level for fiscal year 1980 despite price increases and higher service levels. However, there is a proposed recission of $322,000 that is now pending in congress. Therefore, our request this year is quite lean and austere.

RESOURCE REQUIREMENTS

With your permission, Mr. Chairman, I would like to provide for the record charts which illustrate the breakdown of the total fund request and the products and services expected to be derived from the fiscal year 1981 resources. Postage continues to consume the predominant portion of our funds. This largely uncontrollable expenditure will reach a level of $76 million in 1981, roughly 40 percent of the entire appropriation, but only $154,000 higher than in 1980.

Employee services in 1981 are estimated at 2,696 average positions for a total cost of $50 million, including all fringe benefits. This represents another 27 percent of the total funds. The 1981 estimate is a net reduction of 54 average positions from 1980. With the dollar savings from those 54 average positions we are able to fully absorb added costs for within grade salary increases and the annualization of the 1980 pay raise and still cut personal service cost by $542,000.

The next largest share of our funding request is $34 million or 18 percent, for reimbursement to the commercial banks and the Federal Reserve banks for services rendered. Together, postage, employee services and reimbursement costs represent 85 percent of our total funding needs.

The chart depicting the services and benefits derived illustrates that 67 percent of the resources requested are applied to our disbursing and cliams activity. Sixty percent of the total money for this activity is for postage alone.

Summarizing briefly, the net changes in 1981 consist of:

Activity No. 1 -Disbursement and Claims, a reduction of 72 average positions and $1,985,000. Activity No. 2 - Governmentwide Accounting, an increase of 10 average positions and a reduction of $373,000. Activity No. 3 - Banking and Cash Management, an increase of 8 average positions and $34,000. Activity No. 4 - General Financial Services, no change in average positions and a reduction of $25,000 for a grand total reduction of 54 average positions and $2,349,000.

I believe this gives you a broad outline of the purses and requirements of our Bureau for 1981. Now, I uld like to elaborate on some of the key components.

WORKLOAD INCREASES

Payments, either in the form of a check or a direct posit through electronic funds transfer, are issued by r Bureau. In 1981, the disbursement workload financed this appropriation is expected to rise by 2.4 percent about 17 million payments - reaching a new high of 714 llion units of output. The net funding increase for is workload is $1,031,000. Various plus and minus ctors make up this increase. Processing costs for the creased check volume are $133,000 with postage costs ing $1,953,000 for a total of $2,086,000. However, we stimate that 14 million units of the workload will be onverted from checks to direct deposit resulting in a avings of over $1 million. Thus, we are able to absorb lightly over 50 percent of the cost.

With your permission, Mr. Chairman, I have for the ecord additional charts portraying the payment operation n terms of workload, employee years, costs and productiity. I also have charts for our composite workload onsisting of payments as well as claims processed and hecks paid and reconciled.

Another area where our workload is increasing is n banking and cash management. Recognizing major weakesses in agency systems of financial management and conrol, the Office of Management and Budget has initiated financial priorities program. Three of these prioriies -- Cash Management, Debt Collection, and Grant inancing -- involve our Banking and Cash Management ctivity directly and two others impact us as well. We urrently have an advance financing program that is designed to maximize the availability of funds to the Treasury by controlling the timing of payments to recipient organizations. In recent years, we have made much progress in this area largely through the use of the letter-of-credit method of financing. Even so, the related outstanding cash balances continue to be excessive. If you consider that each one-day delay in average letter-of-credit outflows translates into a $375 million increase in daily Treasury cash availability, it becomes obvious that improvements in this area can result in significant economic returns to the Government. In addition to the advance financing program, we have increased use of the Treasury Financial Communications System to (1) accelerate availability of inflows and (2) allow large outlays to be made precisely on the due date, not early or late. Our cash management program requires continual monitoring and improvement if we are to maximize Treasury's operating cash which now earns interest under the Tax and Loan Investment program. In 1981, our plans include future standardization of cash management procedures and guidelines for Federal agencies.

Increased activity in the Treasury tax and loan account program requires 3 positions and $61,000. We are also seeking 5 positions and $108,000 for new initiatives. Our efforts in 1981 are expected to generate additional savings to the government of almost $23 million in annual interest costs.

ADP EQUIPMENT

The 1981 appropriation request also contains $490,000 for replacement of digiprint systems. At the present time, the Division of Disbursement is using three 15 year old digiprint systems to microfilm payment issuance data used in claims processing. We have three of the four recorders of this type ever made by the vendor who maintains this equipment under a special contract with us even though it has been out of the computer output microfilm business for a number of years. Since they are unique systems, there are no comparable or compatible backup systems available. In addition, it does not appear that these systems will interface with the modern ADP systems we plan to acquire during fiscal years 1982 and 1983. Even if interface were possible, it would involve expensive programming changes not warranted for equipment of this age. We are, therefore, requesting $490,000 for acquisition of updated computer output microfilm equipment.

CHECK PAYMENT AND RECONCILIATION REDESIGN

Our check payment and reconciliation (CP&R) system pays and reconciles all checks drawn on the United States Treasury and identifies the status of all checks claimed to be lost or stolen. In addition, the CP&R system supports the Bureau's adjustment functions with the FRB's and provides check issue and payment data to our central accounting system. This system was designed in 1955, for data processing capabilities and Treasury requirements existing at that time. In the 25 years since its design, the environment in which the system operates has changed drastically. However, the fundamental processing has never been redesigned to accommodate the new demands made upon it. To satisfy new requirements we have had to modify or add on to the basic system. This deferred the need for a major redesign effort but has limited our ability to meet user needs and enhance the efficiency of the operation. Additional add-ons are increasingly more difficult, less efficient, and, in some cases, not feasible. The problem affects all organizations and individuals who issue and receive payments or place claims against Treasury checks.

We are requesting 10 average positions and $486,000 in our 1981 budget to design a new system which will insure timely processing of check issue data and improve turnaround time for processing check claims.

This highlights the major program increases, in terms of cost, anticipated in 1981. We do have several other programs amounting to $168,000 in the aggregate that are outlined in the support material already provided to you. The budget request also includes $1,217,000 to maintain our current operating levels. Over half of this amount is for the increased cost of raw materials and increased charges from the General Services Administration for space related costs.

CHECK CLAIMS

Another major area of concern is our check claims operation. However, at this time, we are not requesting additional funding for this activity. Since checks are eliminated under the direct deposit system, the increasing public participation in that program should have a stabilizing effect on the volume of claims actions related to losses, thefts and forgeries. Because we no longer project increasing claims workloads, we are concentrating our efforts on clearing up work backlogs and reducing account receivable balances.

To accomplish these goals, we must correct certain operational problems to speed the retrieval of original paid checks needed by the U.S. Secret Service in the investigation of forgery cases and accelerate our collection efforts including requests for refunds from banks cashing forged checks. This work is being undertaken in conjunction with longer range improvements to prevent future problems. We also plan to install an improved management and financial information system which will give us better data on all aspects of the claims program.

ACCOMPLISHMENTS

On the other side of the coin, we are projecting significant funding decreases in many areas of the Bureau. These decreases amount to $5,964,000 and are itemized in our summary justification.

With your permission, I would like to mention a few of our major accomplishments which significantly reduce our funding requirements.

DIRECT DEPOSIT/ELECTRONIC FUNDS TRANSFER PROGRAM

In fiscal year 1979, 119 million payments were issued using the direct deposit/electronic funds transfer system. Use of direct deposit is the most effective way we have of reducing our postage costs. Using a 13 cent per item rate, which assumes that all the payments would have been subject to our presort discount, we calculate a $15.5 million recurring annual savings in postage alone. Operational costs are also avoided as a result of fewer claims for lost or stolen checks which are expensive and time consuming to resolve.

Promotional efforts undertaken, including a campaign under the auspices of the Advertising Council should assure further success for this program. In 1981, we are estimating an additional 14 million direct deposit items over the 1980 estimate for a total of over 149 million payments. We are confident that we can meet this goal and have reflected an additional decrease of $1.8 million in computing our 1981 postage expense.

There remains some uncertainty regarding reimbursement to the Federal Reserve banks for services in this area. The matter is still under negotiation.

PRESORT PROGRAM

Another program which has significantly reduced our postage expense is the zip code presort operation. We have been phasing in the program since November, 1976 and are now presorting an average of 370 million recurring payments each year as well as approximately 50 million tax refund checks during the peak period of February through June. In fiscal year 1979, we had a total postage savings of almost $9 million with a net savings of over $8 million after considering our operating costs. In fiscal year 1980, we will begin presorting civil service annuity checks thereby adding another 8 million items to the total presort volume. This program is now firmly established. The entire $8 million recurring postage savings has been reflected in past budget submissions. We consider this a very worthwhile program but do not anticipate that it will have any additional impact on future appropriation needs unless we are forced to reduce or eliminate the program due to lack of computer systems time. This is a distinct possibility unless we acquire new computer systems in the very near future.

TREASURY TAX AND LOAN PROGRAM

The Department implemented the Treasury Tax and Loan Investment Program on November 2, 1978. As you know, under this arrangement Treasury earns a return on its tax and loan funds by investing them with depositaries maintaining open-ended note accounts. The depositaries pay interest on the funds deposited and invested with them. In return for services provided, our Bureau compensates the depositaries at a rate of 50 cents for each Federal tax deposit processed. In fiscal year 1979, this fee payment cost the Bureau $23.6 million for eleven months and the program yielded gross earnings of $646 million to the Government.

We have included $27.3 million in our budget for the full year of 1981. However, the Bureau has contracted with Arthur Young and Company, a certified public accounting firm, to conduct a comprehensive review of the 50 cent fee to determine whether it represents adequate reimbursement for the true cost to the depositaries for the services they provide. We expect the study to be completed early this summer. Depending upon the results of the study, additional funding may be necessary.

TREASURY FINANCIAL COMMUNICATION SYSTEM

Another successful program which I would like to mention briefly is the Treasury Financial Communications System. This electronic funds transfer system provides Treasury with an effective vehicle to significantly improve cash management throughout the Government. The system is being converted from a shared to a dedicated computer environment. With operation of the dedicated computers scheduled for fiscal year 1981, we will greatly improve reliability and security of the system as well as support an Electronic Funds Transfer Letter-of-Credit application. In 1979, interest savings resulting from the acceleration of receipts were calculated at $56 million using a 6% rate of interest. Using the same rate for comparison purposes in 1981 we anticipate that annual interest savings will grow to $65 million -- an increase of $9 million over 1979. The 1981 budget does not contain any additional funding for this program. However, we do plan to seek resources to expand and improve the system in future budget submissions.

CHECK TRUNCATION PROGRAM

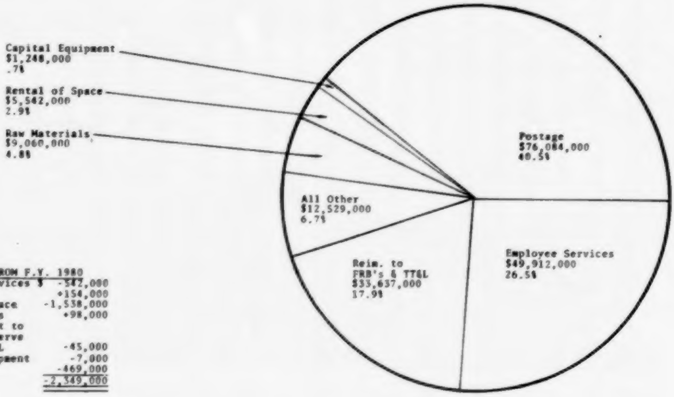
Another program we have recently implemented is check truncation. This system provides for stopping, or truncating, the flow of checks at the twelve Federal Reserve banks where key information is converted to microfilm and magnetic tape which is sent to the Bureau for processing. We are generally pleased with the program but have experienced some operational difficulties. The objective of the system is to obtain payment information quicker while reducing the costs of shipping and handling of hundreds of millions of checks. Although we are currently experiencing some improvement, during fiscal year 1979 the flow of payment information was not as fast as we had anticipated. The combination of accelerated issuance of replacement checks in our claims operation without a commensurate acceleration in availability of payment information resulted in an increase of duplicate payments and work backlogs in the claims area. Improvement efforts should result in the truncation system functioning as originally planned.

SUMMARY AND CONCLUSION

This is the story for the salaries and expense appropriation, Mr. Chairman. Because of the uncontrollable but relatively predictable nature of our work, it lends itself to a straightforward calculation of resource requirements. We feel that this request adquately reflects our needs. I appreciate this opportunity to report on the Bureau's activities and will be pleased to answer any questions from the Committee at this time.

1981 APPROPRIATION REQUEST . . . $188,012,000

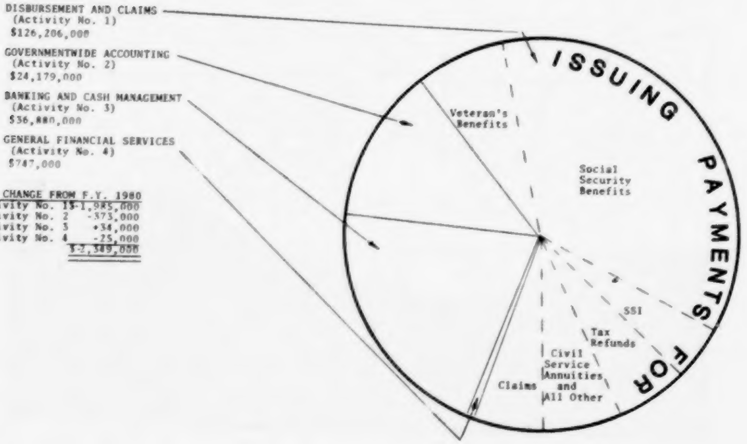
RESOURCES



NET CHANGE FROM F.Y. 1980	
Employee Services	$ -542,000
Postage	+154,000
Rental of Space	-1,538,000
Raw Materials	+98,000
Reimbursement to Federal Reserve Banks & TT&L	-45,000
Capital Equipment	-7,000
All Other	-469,000
	-2,349,000

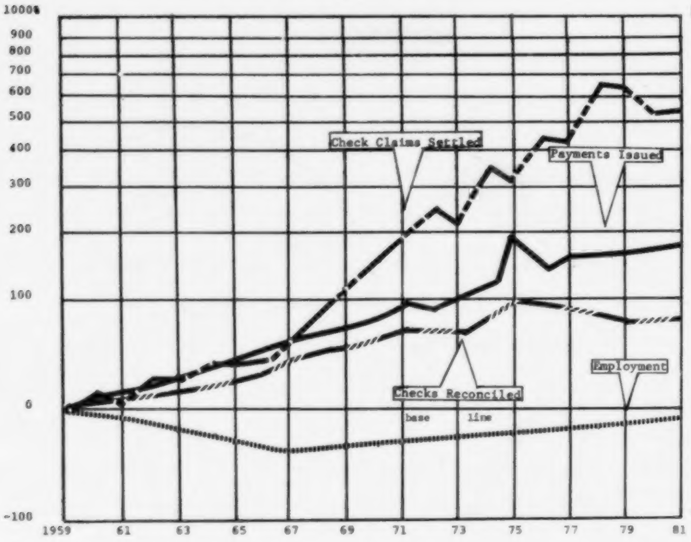
1981 APPROPRIATION REQUEST . . . $188,012,000

PRODUCTS AND SERVICES

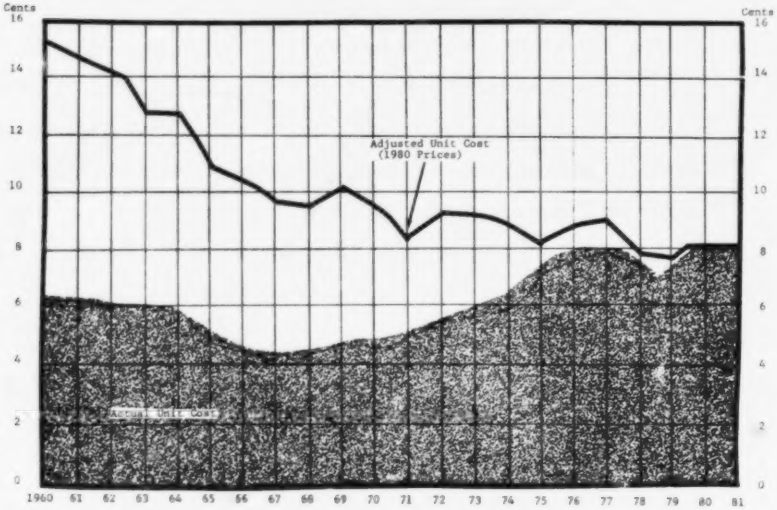


NET CHANGE FROM F.Y. 1980	
Activity No. 1	$-1,985,000
Activity No. 2	-373,000
Activity No. 3	+34,000
Activity No. 4	-25,000
	$-2,349,000

Major Work Out[illegible]s
Percent of Change fr[illegible]se Year

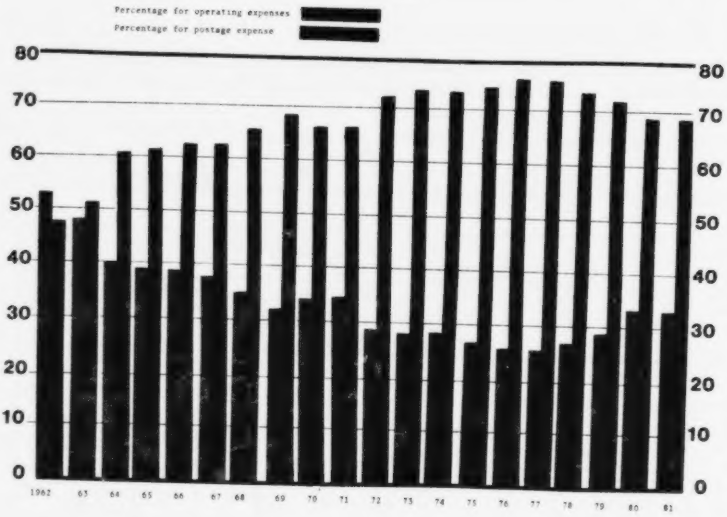


Composite Work Volume Unit Cost



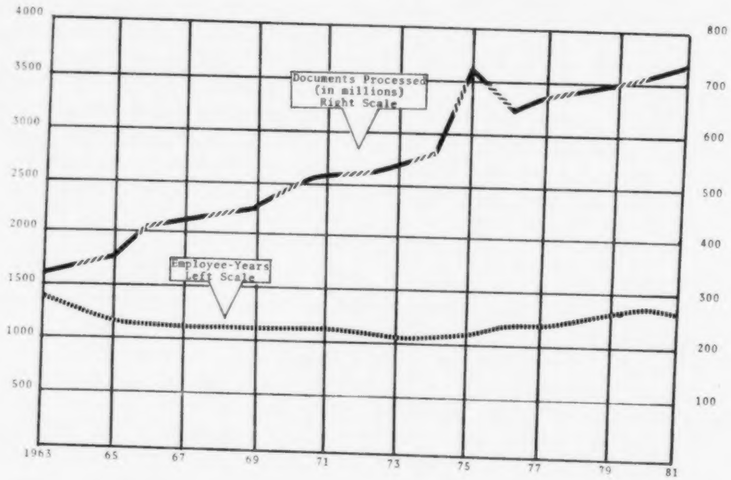
PAYMENT (IONS

RESOURCE APPLICATION



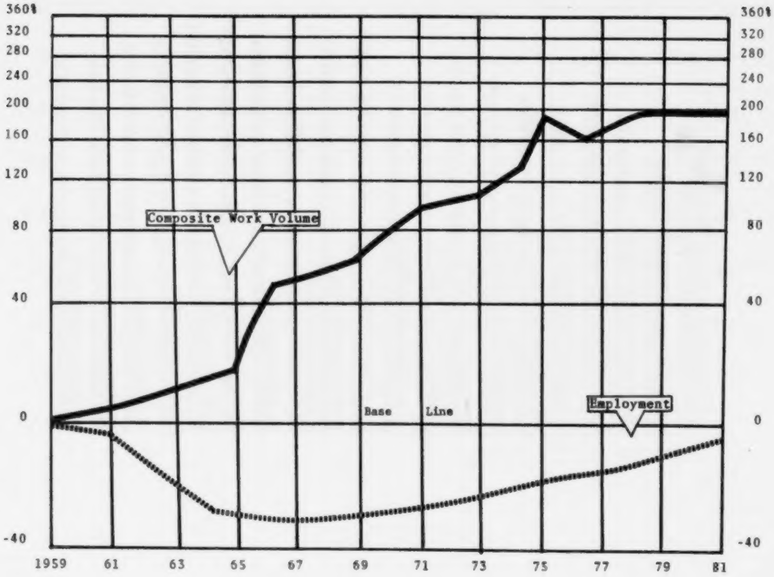
PAYMENT OPER NS

Workload and Employee-Years



COMPOSITE WORK VOLUME - EMPLOYMENT

(Work-years)



CHECK RECONCILIATION

Senator CHILES. Did you have someone else with a brief statement?

Mr. TAYLOR. No.

Senator CHILES. Fine.

I was listening to your statement, Mr. Taylor, and from what you were saying, it is going to take several years to redesign this check payment and reconciliation system. We have been fighting this problem for about 9 years. Why is it going to take several more years now to get it worked out?

Mr. MURPHY. I would like to address that, if I could, Mr. Chairman. You are referring to the check reconciliation?

Senator CHILES. The duplicate check problem.

Mr. MURPHY. Yes, sir. The efforts to improve the operations in the check claims area have been going on for quite a number of years. The earlier symptoms of the problem were basically in terms of complaints about the timeliness of service. And we had a great number of congressional inquiries complaining about the timeliness of service.

As Mr. Taylor pointed out, since 1977 we have probably increased timeliness by about one-third. So we made significant improvements in that area.

However, we have not been able to put together the resources to make major systemic changes in some of the related systems that we rely on heavily, such as our check payment and reconciliation system, which was basically designed about 25 years ago.

There have been a number of initiatives underway which have resulted in some improvement. But the last major effort was a massive systems change which involved all of the Federal Reserve Banks and branches and several of our organizational units. We had some serious startup problems in that system.

That system actually added additional functions to the Division of Check Claims and increased the reliance on some manual processing which affected the productivity in that area. A lot of those problems are being addressed now. We have had some notable success and have identified other areas for improvement. Those are the ones that our plans for the future address, both short and long range.

CLAIMS OPERATIONS

Senator CHILES. Based on the data presented to us, the claims volume has not deviated by as much as 10 percent over the last 4 years. If that is true, that would indicate that the backlog is due to a decrease in the productivity rather than an increase in the volume.

Mr. MURPHY. In terms of the productivity per employee, yes, sir. Our claims volume has remained pretty much the same. With the new system that was implemented, however, we have added additional functions in that division. There are additional requirements for those people now so that the claims output per employee may well have gone down.

At the same time, we received some benefits in the Division of Data Processing because they no longer had these millions of physical checks coming in to be processed there. So we have had some workload shifts within our divisions.

LACK OF RESOURCES OR KNOWLEDGE

Senator CHILES. Well, is the reason that it is going to take several more years, according to your testimony, to clear this up because you don't have the resources, or is it because you don't know what to do? If we have had this problem since 1971, and at that time the Congress provided a bunch of computers, and you put those in, studied it, and in 1973 I think you took them back out again, it looks like we have studied the problem a pretty long time. It has been there for a long time. Do we know what to do? Is it a question of resources? What is it?

Mr. TAYLOR. Let me give at least a general overview from my perspective. In this particular effort to improve the claims operation—and, this is the first one I have been involved in any detail, so I can only speak from personal experience on this particular effort—this is the first time, to my knowledge, we are looking at the problem as a whole, not just as a one division problem. It is looking at the problem not only as it effects the Division of Check Claims but all of the various other divisions and offices in the Bureau. It is also looking at the effect of any efforts on the Federal Reserve Banks, other Government agencies, and the public. It is looking at all aspects of the problem.

One of the problems we have had in the past is we have patched up something in one part and a problem pops up someplace else. It was not being looked at as a continuous whole. I think for the first time—again, there has been some outside prodding too, and that is probably good—but it is being looked at now in its entirety. That is how I see it at least from my perspective.

Senator CHILES. That is not a very comforting answer, that after 9 years it is for the first time being looked at as a whole. You still haven't told me, if it is going to take 2 years, is it because of the resources or you don't know what to do?

Mr. MURPHY. I think, Mr. Chairman, it is safe to say that this is a problem that has been building over an extensive period of time. There is no quick, easy fix. There are, however, a number of major initiatives which can rectify the problem. It won't happen overnight but we do have very strong, top management support within the Department. We are getting assistance from the Department staffs and other bureaus within the Department. We have sufficient resources to cut into the backlog, to have some quick fixes that will help to some extent, but it will really take a longer term effort to make the major systems changes that will be required ultimately to handle this kind of a volume. I would like to submit for the record a background statement on the development of problems in the check claims system.

Senator CHILES. That statement will be included in the record.

[The statement follows:]

BACKGROUND ON THE DEVELOPMENT OF PROBLEMS IN THE CLAIMS SYSTEM

Problems with the claims system are long standing. The underlying difficulties have primarily been manifested by slow service to claimants for lost or stolen Government checks. In the early 1970's, ineffective management resulted in poor service and low employee morale. To increase efficiency, an ambitious effort was undertaken to automate the Division of Check Claims. By 1973, it was clear that management had failed to bring about the desired improvements.

The Fiscal Assistant Secretary at that time transferred responsibility for the automation project from the former Treasurer's Office to his own staff in March 1973. Computer equipment that had been rented was used for tape processing of paid check information and excess computer time was shared with other agencies to insure full utilization. The scope of the automation project was scaled down considerably.

In August 1973, a new Division Director was appointed to improve service and employee morale. In February 1974, the check payment, reconciliation and claims function from the former Treasurer's Office were merged with another bureau to form the Bureau of Government Financial Operations. (NOTE: The computer rented by the Treasurer's Office was subsequently upgraded and also used to develop and operate the Treasury Financial Communications System. That system now generates interest savings to Treasury of over $56 million a year.)

In August 1974, the Fiscal Assistant Secretary's staff developed the first agency agreement to provide claims data on magnetic tape to improve service to claimants. That staff was also directed to make a comprehensive management review of the Division of Check Claims. The review identified numerous management deficiencies. Furthermore, service to claimants was still not satisfactory. In 1975, members of Congress introduced 16 bills to require more rapid issuance of replacement checks. In May 1976, the staff recommended that the claims function as well as the check payment and reconciliation function be decentralized to Treasury regional disbursing centers. This proposal was not adopted by management for a number of reasons including the long lead time required for full implementation which would have precluded immediate service improvements to claimants. At the time, there was also a class action suit pending against the Government to compel expeditious issue of substitute Supplemental Security Income checks.

While the claims operation was not decentralized, a major new system for truncating the physical flow of checks and receiving paid check data on magnetic tape and microfilm was pilot tested in June 1976 with one Federal Reserve Bank. This system was intended to speed the flow of payment data to Treasury. In December 1976, the Claims Modernization Project Staff (CMPS) was set up to make service improvements in the centralized claims operation. The Office of the Fiscal Assistant Secretary also made an extensive review of the operation and identified the need for additional improvements in April 1977. It also developed a plan to accelerate the issuance of substitute Supplemental Security Income checks in response to the class action suit. In July 1977, the Director of the Division of Check Claims was reassigned to the modernization

4. BGFO Audit Staff, assisted by technicians and professionals familiar with DCC operations, undertook a major data gathering process, including an inventory of cases and aging of receivables using a statistical sampling approach. Since October, this effort has taken over 7000 staff hours.

5. BGFO detailed experienced supervisors in March from other Divisions to DCC until permanent positions could be filled.

6. On March 1, 1980, BGFO had over 150 vacancies. A major recruitment effort is in process to fill critical vacancies by June 1980. The Department has detailed personnel specialists to BGFO to assist recruitment efforts for the Division of Check Claims.

7. Some computer hardware enhancements were accomplished with Department assistance.

8. BGFO established a Steering Committee to work on start-up problems under the new Truncation system.

9. Meetings were held with Federal Reserve Banks on start-up problems under the new Truncation system. A reporting system was established to monitor FRB turnaround, goals, etc. In the latest reporting month, 99% of all paid check data was submitted to BGFO within 8 days. The ratio of paid to outstanding items when claims are received has been reversed from 45/55 percent to 55/45 percent.

10. A bureau Task Force began preliminary planning to redesign the 25 year old Check Payment & Reconciliation System. Additional funding for this effort was requested in the FY 81 budget.

11. The DCC is located in a 62 year old "temporary" World War I building which until recently, was scheduled for destruction. Some improvements were made in physical and safety conditions in the building, which is known as the "Liberty Loan Building" (windows, paint, wiring). BGFO is working with GSA to provide additional improvements.

12. Major renovations were made at the Ford Plant in Alexandria so BGFO's supply, distribution and service functions can be relocated in May. This will provide an additional 13,000 sq. ft. in the Liberty Loan Building so organizational and facility improvements can be made.

13. The Treasury's Inspector General conducted a four month study of alleged employee misconduct and found no evidence of any violation of law or the Treasury code of conduct.

14. Documentation on about $600,000 in pending requests for refund over a period of years with Bank of America were assembled and furnished to the bank for review and payment or proof of prior payment.

15. BGFO and legal staff stepped up study of possible legal/regulatory changes. (Set-off procedure, charging interest, declination and limit time for negotiability will be considered for the future.)

project and a new director was appointed.

Substantial improvements were made in service to claimants between January 1977 and January 1979. During that period, approximately one million claimants received replacement checks. In cases where original checks had been paid with forged endorsements, the waiting time for claimants was reduced by 1/3 — from three months to two months. In cases where original checks were still outstanding upon receipt of a claim, the waiting time for claimants was cut in half — from almost a month to less than two weeks. In light of these service improvements, the Claims Modernization Project was closed out in December 1978, and most of the analysts were transferred back to their former divisions. (The Bureau placed a freeze on the hiring of analysts for 15 months in order to insure that positions would be available for these employees when their temporary assignment was completed.)

While service to claimants had been improved considerably, problems in other areas soon became evident. The new truncation system became fully operational in October 1978, and unanticipated start-up problems were encountered by the Federal Reserve Banks and several divisions within the Bureau. The Secret Service noticed a significant drop in the referral of alleged forgeries from the Division of Check Claims. While there were reasons to expect some decline in referrals, BGFO was unable to account fully for the significant drop. Secret Service began an investigation in April 1979, and reported its findings in July 1979.

The accelerated issuance of substitute checks, coupled with initial delays in receipt of paid check data under the new truncation system, resulted in a dramatic increase in duplicate payments. While the new truncation system eliminated the shipment of hundreds of millions of checks for processing by the Division of Data Processing, it required heavy reliance on microfilm quality for most claims activities and added new functions and procedures in the Division of Check Claims. It also provided for regional storage of checks requiring a rather complex process for obtaining the originals. Since the Secret Service requires original checks, the volume of forgery referrals was severely impacted.

To bring about permanent solutions to these problems, a comprehensive series of both short and long range initiatives are underway with full top management involvement and support.

SUMMARY OF TREASURY DEPARTMENT INITIATIVES JULY 1979 TO PRESENT

1. Department established O/S Oversight Group in August 1979.

2. BGFO hired 91 temporary employees in September 1979 to work off a specific backlog of 90,000 cases.

3. Night shift was set up to increase production of microfilm check copies in the initial claims processing area of the Division in March 1980. Where necessary, additional temporary employees have been acquired to eliminate short-term backlogging situations.

16. A new DCC Automated Accounting System became operational April 1, 1980. It presently includes double payments and will be expanded to include forgery accounts receivable and detailed data on older accounts including an aging of all receivables.

17. A project to automate certain processes to speed requests for original checks was designed and should be operational by May 1980. This Microfilm Index and Check Request System should help accelerate the referral of original checks to Secret Service and provide better response time on claims follow-up inquiries.

18. A consultant was hired to lead a joint management/employee workflow documentation and simplification effort in DCC. Some recommendations have already been made and implemented and further changes are expected by June 1980.

19. A BGFO Action Plan with specific ZBBO's was prepared and reviewed by the O/S Oversight Group.

20. Department provided relief to BGFO from personnel hiring restrictions effective March 1980.

CHECK RECLAMATION

Senator CHILES. When the duplicate check is forged and cashed by a bank, the bank is required to pay Treasury back because the bank is legally responsible for checking the identity of the endorsers. According to a recent Post story, many of the Nation's banks have ignored Treasury's request that they pay back $14 million in Government checks bearing forged endorsements that have been erroneously cashed since 1970.

Is it true that banks have ignored Treasury's request for repayment of the $14 million that is owed to us?

Mr. MURPHY. We do have a receivable from the banks as of the end of last March of $14.7 million.

Senator CHILES. What steps are being taken to recover this money?

Mr. MURPHY. In August 1978 we set up an automated reclamation system which sends out bank reclamation notices and then provides automatic follow-up at 30-, 60- and 90-day intervals.

So far this year, 1980, in the first 6 months of the year, the banks have paid us about $11 million back. However, we are not fully keeping up with the new reclamations. We have been billing a little bit more than we have been getting in, so that the forgery accounts receivable balance has grown slightly, contrary to our experience on the double payment accounts receivable, which we have reduced substantially since reaching a peak in August. The double payment balance in August was about $78 million. At the end of March that is down to $62.8 million.

But with regard to the reclamations from banks, we are working with the Bank of America, for example, who volunteered to cooperate with us and asked us to furnish them all of the information we had on all reclamations that our records showed they owed us. We provided them with that listing. They have asked us to indicate what type of support we would need in case their records indicate that they have paid us.

One of our problems is that occasionally we get payments from a bank or a payee that we can't identify to the specific account. We put those in a suspense account until we can locate where they properly should be credited.

It is possible that for some of our records that show a bank as owing us money, they may be able to provide us with proof they have paid and we may be able to identify those payments.

Senator CHILES. How many banks has Treasury sued?

Mr. MURPHY. We have sued some banks. I don't have a specific number, Mr. Chairman. We have sued some banks in the past. We have not sued very many because the Justice Department is extremely reluctant to prosecute on cases where the checks are very nominal in amount, relatively speaking. Apparently it is not cost beneficial. The last case that we sued I believe was settled in 1977. We have one case pending with the Justice Department now involving one bank, approximately 44 checks, with a value of $16,000. We are waiting to find out whether the Justice Department will decide to prosecute. If they do, we have several more we are putting together which we will send them if the first one is prosecuted.

Senator CHILES. If I look at the graph of these things, it looks like the banks are pretty steadily going up from 1977 where you had approximately $9.5 million, to where you are now up to above $14 million. It would seem to me with that kind of increase you are going to have to toughen your policies somewhat.

Mr. MURPHY. Yes, sir. We will be considering a number of possible alternatives. The possibility of setoffs against other——

BANK OFFSETS

Senator CHILES. What kind of setoff possibilities do you have with banks?

Mr. MURPHY. There are possibilities of setoffs against the credits due banks presenting Government checks. Maybe I could ask Mr. Serlin to comment a little further on that.

Mr. SERLIN. We did issue last year an advance notice of proposed rulemaking in two areas. Setoff was one of them and tightening the form of endorsement regulation was the other.

We received a number of letters back from the banks, banking institutions, regarding both of these policies. We determined at the time to put final rules in on the form of endorsement, and we have turned over to the Treasury counsel the issues regarding the setoff proposal.

There are certain legal objections which were raised and they are being studied in the Department now. We are meeting with them to consider whether to propose the setoff in a formal presentation.

Senator CHILES. I would like to have you keep the committee informed of what you are doing. It would seem to me you need to work out something on that.

Mr. MURPHY. I would be happy to do that.

QUESTIONS BY SENATOR SCHMITT

Senator SCHMITT. Mr. Chairman, this $14.7 million, are those amounts owed as a result of duplicate checks issued by the Government or just forgeries period?

Mr. MURPHY. Those are forgeries.

Senator SCHMITT. Would they include the duplicate check figures?

Mr. MURPHY. No, sir, they would not.

Senator SCHMITT. Cashing duplicate checks?

Mr. MURPHY. No; that is a separate account.

QUESTIONS FOR THE RECORD

Senator CHILES. We have some other questions, but we will ask those questions for the record. We thank you.

Mr. MURPHY. We would be happy to respond to them.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR CHILES

Question: What is the current backlog in both numbers and dollars in the accounts receivable and amounts owed to us by banks?

Answer : As of March 31, 1980, the dollar amount of accounts receivable resulting from double payments and forgeries were as follows:

Double Payment Accounts Receivable	$62.8 million
Forgery Accounts Receivable	$14.7 million
TOTAL	$77.5 million

It would not be appropriate to consider the total amount as "backlog" as there will always be a substantial amount in the process of collection due to the nature of the operation. The total also includes some receivables which are considered uncollectible but remain on the books because we have no legal authority to write them off.

Our present reporting system does not produce reliable data on the number and type of cases. However, in December 1979, the Bureau's Internal Audit Staff conducted a physical inventory and determined that there were approximately 289,000 cases in the Division of Check Claims. This includes all types of cases: old and new; fully developed or incipient; some that are deemed uncollectible; some that are awaiting further information from outside parties before further action; plus, a large but undetermined number which have not been processed on a timely basis by the Division. The latter represent true backlog. The total inventory is continually changing in that cases are being reopened and closed, correspondence and inquiries are being received and responded to, follow-ups, refunds from banks and other parties as well as other operations are continually in progress. In the absence of an automated tracking system, the internal structure of the inventory by age and category must be determined on a statistical sampling basis.

In December 1979, the Audit Staff developed a breakdown of the check claims inventory as follows:

No. of Double Payment Accounts Receivable Cases (48.5% of these are less than one year old; 12% are over four years. 91% of the checks are under $400).	197,790
No. of Forgery Accounts Receivable Cases (44.6% are less than one year old; 8.4% are over four years)	40,940

Non-Receivable Cases (including 37,000 forgeries, most of which involve deceased payees)	50,415
Total No. of Cases	289,145

Question: How many cases are now being referred to the Secret Service each month for forgery investigations?

Answer : For the months of October, 1979, to March, 1980, the numbers of cases referred to Secret Service are 6938, 5972, 4314, 5023, 5493 and 5032 respectively. The total for the six month period was 32,772 for an average of 5462 per month.

Question: What is the progress of the Treasury Department's Task Force effort to redesign the system for processing duplicate checks?

Answer : At the present time, there are a variety of task forces, including the Departmental Oversight Group. However, the main long-range effort that has been initiated within the Bureau involves a redesign of the central check payment and reconciliation system. Although there have been equipment enhancements and other modifications such as truncating the flow of Treasury checks at Federal Reserve Banks, the basic system design is the same as it was when implemented in the mid-1950's. The system currently processes about 700 million checks annually and provides input for a variety of accounting and related functions, such as the claims system.

The redesign program is to develop an updated system which will accommodate the changes and environment of the future while insuring that the short-comings that have been identified over the years are corrected. A notable example involves the limitations of the system which have hampered the implementation of improvements in the claims program.

The redesign task force was established in June of 1979, consisting of operational representatives from each of the major impacted Divisions of the Bureau. These include the Divisions of Check Claims, Data Processing, and Government Accounts and Reports. The Bureau also has a steering committee of senior Bureau managers, with the Assistant Commissioner for Governmentwide Accounting as Chairman. In its redesign, the task force is considering all improvements that can be made in: methods and equipment for timely data collection; timely reporting; management control and information; and system accountability and auditability.

The Task Force is scheduled to develop functional system specifications for internal review next month. This will provide an overview of all procedures, the content and timing of inputs and outputs, descriptions of system interrelationships and processes. The specifications will be reviewed by Bureau top management before we begin necessary identification of computer needs and development of long range implementation plans. For FY 1981, we are requesting 10 average positions and $486,000 for this effort.

With your permission, I would like to provide for the record some additional background information on the claims operation.

Question: What assurances are there that this effort will be successful?

Answer : In contrast to some past efforts, the redesign is a total Bureau program, established and overseen by top Bureau management, with deep involvement from all operating divisions. The redesign task force provides monthly written reports and the steering committee meets monthly with the task force to discuss progress. There are also regular meetings with Division managers to assure consistent input.

The Bureau is deeply committed to insuring that this redesign is successful and will keep the Committee informed as to progress.

Question: How many pay back agreements have been entered into this fiscal year and what amount of money will be recovered through these agreements?

Answer : An agreement with the Railroad Retirement Board for charging back duplicate payments was implemented in March. Similar agreements with other agencies have been in effect as far back as February 1974. We currently have agreements with the Social Security Administration (covering Supplemental Security Income payments and regular social security benefits), the U.S. Army and Air Force, and the Internal Revenue Service, as well as the Railroad Retirement Board. Decreases to DCC account receivable balances in Fiscal Year 1980 to date through these agreements totaled $10.3 million. Total decreases by collections of all types (including chargebacks to agencies) totaled $34.7 million. These recoveries were offset by new charges to the accounts receivable totaling $24.6 million.

Due to the relatively small volume of Railroad Retirement checks, we anticipate only slight increases in collections through chargebacks to the Railroad Retirement Board.

Question: In this Fiscal Year, what is the number and dollar volume of repayments made by banks to the Bureau with regard to those cases of forgery?

Answer : For Fiscal Year 1980 through March, the number and dollar volume of refunds from banks on forged checks were as follows:

	NO.	AMOUNT
Recoveries on behalf of agencies for checks issued subsequent to payee's death:	17,524	$4,686,915 1/
Recoveries for claims involving other forged checks:	21,345	6,247,993
TOTAL	38,869	$10,934,908 2/

1/ Recoveries are made on these checks pursuant to requests from agencies indicating that the payee died before the check issue date. Although these checks involve forgeries, the amounts are not reflected in the Division of Check Claims receivable accounts. When credits are received from banks, refunds are made to the appropriate agencies.

2/ The number and dollar volume of bank refunds were obtained from the Division of Check Claims automated bank reclamation system, which was established in August of 1978. There continue to be a few credits from banks which were issued prior to the establishment of that system. Although reflected in Division of Check Claims suspense and receivable accounts, the number and dollar amount of these items are not readily available. They are estimated to represent about three to five percent of reclamation credits being processed.

PROBLEMS WITH THE CHECK TRUNCATION PROGRAM

Question: In your statement you explained that the check truncation program provides for stopping, or truncating, the flow of checks at the 12 Federal Reserve Banks where key information is converted to microfilm and magnetic tape which is sent to the Bureau for processing. The objective of the program is to obtain payment information quicker while reducing the costs of shipping and handling of hundreds of millions of checks.

I understand from your statement that the system is not working well and there are significant delays in receiving the information. Why hasn't the program worked as well as intended?

Answer : The basic concept of the truncation program has proven to be valid. The initial problem with the system was the failure to achieve the expected fast receipt of payment information from tne Federal Reserve Banks in the beginning phases. Equipment difficulties, coordination and other problems resulted in unexpected slow processing of checks at the banks. There were also delays in the Bureau because of microfilm rejects and other problems. In retrospect, it appears that the testing phase did not involve a heavy enough volume to clearly show the operational deficiencies encountered later with full implementation. However, by use of a Bureau task force since June 1979, many of the intra-bureau coordination problems are being overcome.

The initial Federal Reserve Bank problems relating to delays in check processing have been significantly reduced. Since May 1979, the Federal Reserve Banks have greatly increased turnaround time. The latest reports show the banks are processing 99 percent of checks within eight days after receipt. In May of 1979, for example, only 64 percent were being processed in the eight day time frame.

Question: The failure of the check truncation program to work as well as expected has caused further problems for resolving the duplicate check problem that we talked about earlier. Is that correct?

Answer: The lack of timeliness in receiving payment information, combined with increased speed in processing claims that had been achieved, resulted in a higher proportion of claims being settled by issuance of substitute checks in Fiscal Year 1979. For example, over the years, when claims were processed, it had normally been found that a majority of checks had been paid prior to receipt of claims and processing replacement action. During Fiscal Year 1979, the proportion shifted to a ratio of 45 percent being found paid at the time of claims processing and 55 percent being outstanding. When original checks are outstanding, substitute checks are issued immediately with a risk that both checks may be negotiated. Our recent experience indicates that roughly 20% result in double payments.

During Fiscal Year 1979, these duplicate payments increased significantly over previous years. Although comparable data is not available for prior years, the increased volume of duplicate payments is estimated at roughly 80 percent over the 1977 level.

The increased duplicate payments, combined with heavy reliance on manual procedures in DCC resulted in large increases in account receivable balances in Fiscal Year 1979. Due to the increased timeliness of payment information achieved in Fiscal Year 1980, the proportion of checks reported paid has now increased to 55 percent. Fewer substitute checks are being issued and the double payment accounts receivable balance is being reduced. As short and long term improvements are implemented, we do not anticipate a recurrence of the 1979 problems.

Question: Would the previously used manual system be quicker as it relates to resolving the duplicate check situation?

Answer : It would not be practical to return to the pre-truncation system in view of technological advances. Truncation eliminates the shipment of hundreds of millions of checks from all over the country into Washington, a massive card-to-tape conversion and reshipment of the checks to storage points. Furthermore, improvements have been made to alleviate the 1978-1979 start-up problems and it would not be beneficial or economical to return to the previous system.

Question: I understand that the Bureau has withdrawn its request for $2.1 million to reimburse the Federal Reserve Banks for check truncation services. Do you expect the Federal Reserve Banks to continue these services without payment?

Answer : The Federal Reserve Banks have been providing this additional service and are cooperating in efforts to get the system to operate timely and effectively. We originally requested funds to reimburse the Banks in FY 1981 for their incremental costs. Even without that reimbursement we expect their continued cooperation. However, funding of improvements or higher service levels may become a problem in the future. We generally subscribe to the theory that the recipient of services should pay for them. In that way, Congress can identify the total cost of our operations including such reimbursable items as postage paid to the Postal Service, space rental paid to GSA, etc.

BUREAU AND SOCIAL SECURITY WORKLOAD PROJECTIONS DIFFER

Question: The Bureau is projecting an increase of over 17 million checks to be issued in Fiscal Year 1981. According to the President's Budget, Social Security beneficiaries are only projected to increase by 700,000, representing an additional 8.4 million checks each year. Please explain the discrepancy between Social Security projections for increased beneficiaries and those made by the Bureau.

Answer : The Bureau's projected payment volume for Social Security benefits in Fiscal Year 1981 is 428 million. This is lower than projections developed by Social Security Administration based on the anticipated 31.2 million beneficiaries to be covered by the Federal Old-Age and Survivors Insurance Fund (page 485 of the FY 1981 Budget Appendix) and the 4.7 million expected to be covered by the Federal Disability Insurance Trust Fund (page 488 of the Appendix). Based on the total number of beneficiaries to be covered, 35.9 million, multiplied by 12, a figure of 430.8 million payments would be projected. This would be a difference of less than one percent from the Bureau's projection and is due to different data bases, i.e. there is not a precise one-for-one relationship between the number of beneficiaries and the number of payments to beneficiaries.

CASH MANAGEMENT

Question: $108,000 and 5 positions are requested to implement the new cash management policies. What is in the base for this activity?

Answer : There are $2,772,000 and 86 average positions in our base for this activity.

Question: What are the new policies?

Answer : Due to the importance of cash management, the President directed the formation of a special reorganization project about a year ago which identified 78 initiatives in 15 agencies with potential savings of over $400 million. Treasury is responsible for follow-up on recommended initiatives.

In FY 1980 the total Federal cash flow is expected to exceed a trillion dollars. This equates to a daily flow of over $4 billion each business day with a potential loss in earning value of $400 million for each day receipts are delayed or payments are made early. By law Treasury is charged with managing the Government's cash.

Treasury has directed agencies to develop and implement cash management regulations governing their financial transactions. This activity includes oversight of agency efforts, as recommended by GAO, through the review of regulations and reports, the providing of necessary guidance, and the development and implementation of new policies to keep abreast of changing financial conditions.

Some examples include the establishment and dissemination of an index to use as a basis for determining the time value of money, again as recommended by GAO, and the application and monitoring of such rates for deferred payments, late payments and discounts.

Question: What specifically will the Bureau do to implement the new policies?

Answer : The Bureau will develop and disseminate, in cooperation with OMB, GAO, and GSA, the necessary policies applicable to these financial activities, provide guidance to agencies for their implementation, and continue our monitoring efforts to ensure compliance with such policies.

ADP ACQUISITION

Question: $920,000 is requested for computer acquisition. What is the Bureau's total ADP acquisition plan for the near future?

Answer : The $920,000 originally in our budget was to begin the replacement of the Division of Disbursement's eight major computer systems. We were recently advised that one phase of the procurement process would take more time than we had anticipated and would result in the installation of the computers being shifted into fiscal year 1982. Consequently, with the Administration's recent cut in the 1981 funds we voluntarily removed the $920,000 from our request.

Our plans for the near future now include a request for proposals to vendors for this equipment by about July 1980 with proposals due back in October. A contract award for purchase of the systems is targeted for April of 1981 with installation of the systems to begin in the first regional disbursing center in October of 1981 and be completed in all eight centers by July of 1982.

BASE REDUCTIONS

Question: The Bureau has $5,104,000 of non-recurring expenses and management savings to offset the increase of $6,588,000. What are these non-recurring expenses and management savings?

Answer : With the Administration's recent reduction to the 1981 request, the Bureau now has offsetting reductions of $5,964,000. Non-recurring costs include $163,000 for one less workday, $65,000 for reduced workload in the TT&L program; $521,000 for one time equipment purchases; $801,000 for one time expenditures such as alteration of space and contractual services; $1,012,000 for price adjustments in rental payments to GSA; and, $860,000 for release of funds for a consolidated headquarters building.

The total reduction due to management savings is $2,542,000. This includes savings in compensation and benefits associated with a reduction of 63 average positions. Increased productivity, and greater participation in the Direct Deposit/Electronic Funds Transfer system are the main reasons for this savings.

Question: For each of the bureaus and agencies in the department, please provide a listing of audit and investigation resources expected to be available in FY 1981.

Answer : The Bureau's 1981 appropriation contains $1,416,000 and 38 average positions for audit functions. Nine of these positions and $425,000 are devoted to operations relating to the qualification of surety companies as acceptable sureties on Federal bonds. This is essentially a Bureau financial operation leaving 29 average positions and $991,000 audit resources potentially available to the Office of the Inspector General.

CHECK PAYMENT AND RECONCILIATION SYSTEM REDESIGN

Question: $486,000 and 10 positions are requested for redesign of the CP&R system. Why can't this be done within base?

Answer : The Check Payment and Reconciliation System is a very large and complex computer-based system which pays and reconciles all Treasury checks, processes claims submitted for lost or stolen checks and provides transaction data for the automated maintenance of the Government's financial accounts.

This system was designed 25 years ago and since that time the volume of checks processed have doubled from 350 million to 700 million a year, claims have increased from 300 thousand to 1.8 million a year. Numerous changes to the system have been made in response to legal and other requirements, and the equipment upon which this system has been operating is no longer maintained by the manufacturer.

For these reasons, available programmer and analyst resources including some borrowed from other priority tasks have been engaged in a complicated effort to convert the CP&R system to more modern equipment. Subsequent to this interim upgrade, the same personnel are scheduled to embark on a second phase involving the optimization and maintenance of the converted system. However, conversion and optimization are only interim solutions. The real need is a complete redesign effort. All available resources now assigned to the current effort will be tied up in Phase 2 for the next 24 months. CP&R redesign cannot wait that long. In light of our current problems, it should have started several years ago. Therefore, we consider this request a matter of great urgency and seek your support for the additional funding and positions.

Question: Doesn't the Bureau currently employ people with these skills?

Answer : Yes, there are a number of personnel within the Bureau possessing the skills required by the CP&R redesign effort; however, as already indicated, all programmer/analyst resources are either engaged in the ongoing CP&R conversion effort or essential disbursing and claims applications. Other major conversion efforts have been allowed to slip behind schedule or have been deferred indefinitely.

SUPPLEMENTALS

Question: $2,000,000 is requested for payments to the Government of Guam, Virgin Islands, and American Samoa to compensate these governments for tax losses incurred because of the Tax Reduction and Simplication Act of 1977. What will be paid to each government?

Answer : The government of Guam was paid a total of $3,216,000 in Fiscal Years 1978 and 1979. This supplemental appropriation of $2,000,000 will be used to pay the claim of the government of the Virgin Islands. No claim has been received from the government of American Samoa.

Question: What specifically are the tax losses that resulted to these governments from the Act?

Answer : The losses resulted from the implementation of sections 101 and 102 of the Tax Reduction and Simplication Act, and vary from territory to territory. The amount of the claims represents the tax loss of each government.

Question: How accurate are the estimates of taxes lost?

Answer : The method of computing the tax losses was devised by Treasury's Office of International Tax Affairs using statistical random sampling and was certified by the affected U.S. Government Comptrollers. We believe they are as accurate as possible given the fact that a sampling technique was used.

Question: Is there a way to do a post-audit check? Will this be done?

Answer : It is possible to do a post-audit check, however, since the amounts of the payments were determined by the Secretary of the Treasury upon certification by the U.S. Comptrollers, it does not seem appropriate that Treasury should audit the amounts.

DIRECT DEPOSIT/ELECTRONIC FUNDS TRANSFER

Question: Where do you stand now and what are your plans with respect to your program for Direct Deposit/Electronic Funds Transfer?

Answer : Under the Direct Deposit Program, recipients of Federal recurring benefit payments may choose to have their payments sent to a financial organization rather than to a home address. Payments are made by an Electronic Funds Transfer System, whereby the payments are transferred through the the Federal Reserve System by magnetic tape to the recipients' personal accounts at financial organizations. This system eliminates the mailing of individual checks and significant cost savings are realized.

The Program was expanded in 1977 to encompass all types of Federal recurring benefit payments. The following classes of payments are now included in the Program: Social Security Benefits, Supplemental Security Income, Civil Service Annuity, Railroad Retirement Annuity and Veterans Administration Compensation and Pension. As of April 1980, total enrollment in the Program had increased to 11.5 million which represents 26.2% of the eligible recipients. In an effort to increase participation in the Direct Deposit/EFT Program, many promotional efforts were undertaken in Calendar Year 1979. Through these efforts, approximately 1.9 million recipients were encouraged to enroll in the Program. Additional promotional efforts are underway in 1980, which will again include a major promotional effort with the Advertising Council. The Advertising Council effort includes the development of television and radio public service announcements, check inserts, and magazine and newspaper advertisements. It is anticipated that in Calendar Year 1980, the financial community will also continue to become more actively involved in promoting the Program.

OVERPAID CLAIMS

Question: Tell us about the Secret Service determination that your Check Claims Division overpaid claims by $58.9 million through the issuance of duplicate checks?

Answer : As of April 30, 1979, our accounts receivable for double payments of original and substitute checks totalled $58.9 million. This receivable balance represents the total amount of money to be recovered, either because one of the checks was forged and cashed or because the payee negotiated both checks. The accounts receivable balance reached a high of $78 million in August 1979, but has since been reduced to $62.8 million as of the close of March.

The increases in accounts receivable have been a by-product of faster replacement of lost or stolen checks plus the unanticipated impacts of the check truncation system. Although we are working to reduce current receivables, it should be recognized that there will always be a certain amount of money in the process of collection as long as checks are lost or stolen and must be replaced by issuance of another check. For Fiscal Year 1980 to date, recoveries for the double payment receivable accounts totaled $29.9 million. However, these were offset by $18.7 million in new charges to be collected.

Question: How many claims are backlogged?

Answer : In terms of paying claims to people whose checks have been lost or stolen, claims are not backlogged. On the average, it takes about 50 working days for a replacement check to be issued if the original check was already paid with a forged endorsement at the time the Bureau received the claim or about ten working days if the original check was outstanding. Backlogged work involves the recovery of money and referral of checks for forgery investigations.

As indicated in our response to another question from the Subcommittee, the total inventory of cases in December, 1979, was 289,145. Some breakdown was developed based on a statistical audit sampling. More current or detailed data is not available due to the lack of computer-based, reliable reporting systems. However, on April 1, 1980, an automated accounting system to cover double payment receivables went into effect. The system will be expanded in the future to cover forgery receivables and detailed data on older accounts including an aging of all receivables.

Question: What is the oldest backlogged claim?

Answer : With regard to replacement action, the payee may have to wait four to six months for issuance of a settlement check in some instances. These cases are few in number and involve situations where, in the judgment of the claims examiner, circumstances warrant investigation to insure that the payee did not benefit from the proceeds of the original check before another check is issued.

In regard to collection actions, the Bureau audit of the accounts receivable developed an estimate that about 12 percent of the total double payment case inventory and 8 percent of the forgery case inventory are over four years old. Although we do not at this point have an aging system which would identify the oldest case in the approximately 289,000 total inventory, it should be recognized that the Bureau does not have authority to write off uncollectible cases. As such, they continue to be carried as a part of the receivable balance even after collection efforts have ceased.

Question: How much has been wrongfully paid out and is now beyond recovery?

Answer : Based on the review of accounts receivable by the Bureau's Audit Staff, approximately 3,400 cases totalling about $400,000 have been identified as uncollectible. The General Accounting Office has granted relief on about $252,000 of these items, although we have no legal authority to charge the losses to appropriated funds. When the automated accounting system is expanded and a complete aging of receivables is available, Bureau management will be able to estimate with a reasonable degree of accuracy the total amount beyond recovery. It should be noted that issuance of replacement checks does not represent funds wrongfully paid out. The receivable is created by a payee wrongfully negotiating both the original and substitute checks or someone fradulently negotiating a forged check.

Question: Per month how many check forgery cases do you refer to the Secret Service? Are these referrals on the upswing, and if not, why not?

Answer : During Fiscal Year 1979 the Division of Check Claims referred a total of 46,338 checks to the United States Secret Service for investigation. This equates to 3,862 checks per month on the average and was abnormally low. During the first 6 months of Fiscal Year 1980, a total of 32,772 checks have been forwarded, representing 5,462 per month on the average. The FY 1980 activity represents an average monthly increase of 1,600 but is still lower than it should be. The actual per month referrals have been submitted for the record in response to another question posed by the Subcommittee.

Question: What was your largest check issued as a duplicate payment? (I believe it was a $200,000 check made out to the UN-FAO in Rome.)

Answer : The $200,000 check referred to in your inquiry involved a double payment to a United Nations organization through the American Embassy in Rome, Italy. The double payment intercepted in October 1978 and the Embassy refunded the double payment with a check dated February 1979.

We cannot readily determine the largest check issued as a double payment. We do have in operation a procedure to identify all double payment items with a value of $5,000 or more. These items are included on a weekly report to management with timeliness of action indicated in connection with closing the case. According to the most recent report for the week ending April 18, 1980 the largest outstanding double payment item was in the amount of $217,372.12.

Question: What is the status of the Bureau's ADP replacement programs?

Answer : As mentioned earlier, we anticipate that a request for proposals to replace the obsolete computer systems at the eight regional disbursing centers will be released by July 1980, with installation of the new systems scheduled to begin in October 1981 and to be completed at all disbursing centers by July 1982.

Additionally, the Bureau is presently acquiring some equipment components as an interim upgrade to the systems located in the Division of Data Processing. This upgrade will not require additional funding but will provide more reliable and efficient equipment. We anticipate completion of the installation of this equipment in early Fiscal Year 1981.

We anticipate the completion of a feasibility study during the latter part of Fiscal Year 1980, to determine the need for replacing the total equipment complement in the Division of Data Processing in Fiscal Year 1983. This study will consider the useful life expectancy of the installed equipment as well as the Bureau's equipment needs for implementation of the redesigned Check Payment and Reconciliation System and the automation of the Check Claims process. We anticipate that the study will identify the need for equipment replacement in Fiscal Year 1983 to provide for modernizing and improving these systems and other processing improvements.

BUREAU OF THE PUBLIC DEBT

STATEMENT OF H. J. HINTGEN, COMMISSIONER OF THE PUBLIC DEBT

ACCOMPANIED BY:

PAUL H. TAYLOR, FISCAL ASSISTANT SECRETARY
WILLIAM M. GREGG, DEPUTY COMMISSIONER
KENNETH W. RATH, ASSISTANT COMMISSIONER, WASHINGTON
RICHARD L. GREGG, ASSISTANT COMMISSIONER, FINANCING
ELEANOR J. HOLSOPPLE, ASSISTANT COMMISSIONER, ADMINISTRATION
DAVID P. NEVERMAN, DIRECTOR, DIVISION OF FINANCIAL MANAGEMENT
ARTHUR D. KALLEN, DIRECTOR, OFFICE OF BUDGET AND PROGRAM ANALYSIS, DEPARTMENT OF THE TREASURY

U.S. Savings Bonds Division

STATEMENT OF AZIE T. MORTON, TREASURER OF THE UNITED STATES AND NATIONAL DIRECTOR

ACCOMPANIED BY:

WILLIAM A. GREINER, DIRECTOR OF ADMINISTRATION
VINCENT P. VALLELY, ACTING BUDGET OFFICER
H. J. HINTGEN, COMMISSIONER OF PUBLIC DEBT
ARTHUR D. KALLEN, DIRECTOR, OFFICE OF BUDGET AND PROGRAM ANALYSIS, DEPARTMENT OF THE TREASURY

BUDGET REQUEST

Senator CHILES. The committee will now receive testimony from the Bureau of the Public Debt regarding the fiscal year 1981 budget request and the fiscal year 1980 supplemental request. $196,625,000 and 2,671 permanent positions have been requested for fiscal year 1981 and $26,174,000 is requested for the fiscal year 1980 supplemental.

The committee is pleased to have Mr. Hintgen, the Commissioner of the Public Debt, to submit testimony in support of these requests. We are also pleased to have Mrs. Azie Morton, the Treasurer of the United States and National Director of the U.S. Savings Bonds Division, with us today.

PREPARED STATEMENTS

Mr. Hintgen, we will insert your full statement in the record, together with the statement of Mrs. Morton. The committee would be pleased if you would provide us with a brief highlight of your request.

[The statements follow:]

STATEMENT OF H. J. HINTGEN

Mr. Chairman and Members of the Committee, I appreciate this opportunity to discuss with you our 1980 supplemental request and our 1981 appropriation request for "Administering the public debt."

This appropriation provides funds for the Bureau of the Public Debt and the U. S. Savings Bonds Division. The latter is a separate organization for promoting the sale of savings bonds and reports directly through the National Director to the Under Secretary. Representatives of the Division will appear later to justify their requirements, which are separately identified in the justification material.

The Bureau of the Public Debt is responsible for the administrative functions arising from the Treasury's debt management activities. Those functions relate to transactions in security issues of the United States and of those Government agencies and instrumentalities for which the Treasury acts as agent.

The Bureau currently maintains an office in Parkersburg, West Virginia, as well as the headquarters office in Washington, D. C. The Federal Reserve Banks and Branches conduct public transactions as fiscal agents of the United States. Most banks and other financial institutions act as issuing and paying agents for the sale and redemption of savings bonds and notes.

The Bureau is a service organization which has no control whatever over the factors that generate its workload. Those factors are created largely by the extent of participation in the financing that is necessary to fund Federal programs and operations and to refund outstanding debt. The Bureau must issue, service and redeem the securities that represent the tangible results of that participation. It has no options or loopholes that will allow it to evade the timely discharge of its responsibilities to investors or the prompt payment of its contractual obligations to the Federal Reserve Banks as fiscal agents, to its savings bond issuing and paying agents, and to the Postal Service.

The problem of control is further complicated by the fact that only about 28 percent of the appropriation is allocated to Bureau operations. Some 8 percent is allocated to the Savings Bonds Division, and the balance is required to reimburse the fiscal agents, issuing and paying agents, and Postal Service for contractual services.

1980 SUPPLEMENTAL REQUEST

We are requesting a supplemental appropriation of $26,174,000 for 1980. A request of $9,774,000 was submitted with the President's budget; subsequently this request was amended to add $16,400,000. Of the total, $23,558,000 is for program increases and $2,616,000 is to cover the October 1979 pay raise.

The program increases are necessary because of the impact of record high interest rates on both of our major programs. The savings bond program is the victim of massive disintermediation, as owners cash their bonds in record numbers and reinvest the proceeds to take advantage of the higher rates available in a variety of other investments, including Treasury marketable issues. On the other hand, we are almost overwhelmed by the number of investors purchasing these marketable issues, and particularly by individuals who are attracted to the Treasury bill accounts maintained in book-entry form by the Bureau.

The major portion of the supplemental funds -- $23,188,000 -- is required to enable us to meet our contractual commitment to pay a fee of 30¢ for each bond redeemed by a financial institution serving as paying agent. Redemptions are at the highest level in the history of the savings bond program. In the first six months of this fiscal year, they were 84 percent higher, in terms of dollars paid out, and 49 percent higher, in terms of pieces processed, than in the corresponding period of the preceding fiscal year. For the three months that ended on March 31, 1980, the volume of redeemed bonds has averaged in excess of 1.1 million pieces a day, an increase of 63 percent over the corresponding quarter in 1979.

Additional funds of $134,000 for 15 average temporary positions are also requested to provide personnel to process this unprecedented workload.

The impact of high interest rates on marketable issues is reflected in the increased number of accounts maintained by the Bureau.

The number of accounts for registered Treasury bonds and notes has increased in the past year from 485,000 in the amount of $13.2 billion, to 604,000 in the amount of $15.2 billion. This represents an increase of almost 24 percent in the number of accounts that must be serviced.

The effect of the Treasury bill accounts is even more dramatic. At the time the FY 1980 estimates were developed, the Bureau was maintaining 24,000 accounts in the amount of $0.6 billion, and we projected a level of 26,700 for the budget year. We actually had 203,000 accounts, representing $3.67 billion, at the beginning of the year. The current total is 393,000 accounts, in the amount of $6.16 billion. The number of accounts is 417 percent higher than a year ago. During recent months the new accounts have been increasing at an average of more than 10,000 a week.

The supplemental request provides $236,000 and 21 average temporary positions to help us deal with this unexpected and totally uncontrollable surge in the marketable workload.

Also included in the supplemental request is $2,616,000 to provide for the costs of the October 1979 pay raise. This amount includes $2,244,000 for the Bureau of the Public Debt and $372,000 for the U. S. Savings Bonds Division.

1981 APPROPRIATION REQUEST

We are requesting an appropriation of $196,625,000 to carry out the responsibilities of the Bureau of the Public Debt and the Savings Bonds Division in fiscal year 1981. This amended request represents a reduction of $2,200,000 from the amount included in the President's January budget.

The fiscal year 1981 request is $13,015,000 below the proposed authorized level for 1980. Program increases in 1981 amount to $10,012,000 and other increases necessary to maintain current staff levels total $2,418,000. These increases are offset by reductions of $25,445,000 from savings and non-recurring costs. No new positions are included in the request, notwithstanding the continuing growth in the debt, which stood at $863.5 billion on March 31, 1980.

This is an austere budget request that is predicated on two basic assumptions.

The first assumption is that economic conditions will improve and that this improvement will result in a substantial reduction in the current rate of inflation, as well as in the average interest rate paid for Treasury market issues, which reached historic highs within the past month.

The second assumption is that these improved economic conditions will lessen the Bureau's workload by drastically reducing the present level of individual participation in Treasury marketable offerings and by lowering the unprecedentedly high volume of savings bond redemptions we are currently experiencing.

The 1981 request does not include either the funds or the personnel covered by the 1980 supplemental requests which have been submitted.

There are several major items included in the request -- in addition to the volume estimates -- that deserve special mention.

ISSUING AND PAYING AGENT FEES

We are asking for $8,368,000 to implement a higher fee schedule for savings bond issuing and paying agents. This adjustment will bring the fees more nearly in line with the agents' actual costs for handling these transactions.

The current schedule was based on a 1974 study, and at the time of its adoption the agents generally protested that it was too low. As a result, the Bureau cooperated with the American Bankers' Association in surveying cost data in a cross-section of financial institutions. The revised fee schedule provides for increases which reflect the demonstrated need to increase the rate of compensation as a means of maintaining the viable network of issuing and paying agents that is essential to the success of the Program.

We have, for the record, a table that shows the current and proposed fees in detail and the total impact of the increases on the appropriation.

FEDERAL RESERVE BANK REIMBURSEMENTS

We are requesting a total of $34,387,000 to reimburse the Federal Reserve Banks in FY 1981 for their services, as fiscal agents, in the conduct of public debt transactions. This amount includes an increase of $1,303,000, attributable to normal cost and volume factors. As you know, the Reserve Banks play a major role in the conduct of public debt operations and function very much like field offices of the Bureau in this area. They are reimbursed for the services they perform, under long-standing agreements that provide for the careful review and audit of costs by the Bureau and for the essential Congressional oversight through the appropriation process.

NEW SERIES SAVINGS BONDS

As of January 1, 1980, the Treasury introduced the new Series EE and HH savings bonds, which replaced the offering of Series E and H bonds. Over-the-counter sales of the latter series were discontinued on December 31. Payroll sales are to be converted from Series E to EE no later than June 30.

The new Series EE bonds are sold at 50% of their face amounts. The interest rate is 6.5% on bonds held for at least five years and 7% on bonds held to the maturity of 11 years. The minimum holding period has been increased from two to six months, with the objective of reducing overall borrowing costs by requiring purchasers to retain their bonds for a longer initial period.

We expect these changes to produce appreciable recurring savings in administrative costs. The 1981 budget includes savings of $2,335,000 and 7 average positions attributable to the changeover. While it is too early to judge the results of the Program changes, we are happy to report that the conversion effort to date is being carried out with a minimum of serious problems.

PROCESSING TREASURY-BILL ACCOUNTS

We have also included in this appropriation request funds to provide for the full-year costs of contractual services for processing applications for individual Treasury-bill accounts. We are currently in the process of negotiating a contract to this end, in order to relieve some of the workload pressures in this area. We project the full-year costs for this service at $600,000, requiring an increase in 1981 of $350,000 over this year's funding level.

CONCLUSION

Mr. Chairman, this concludes my prepared remarks. I will be glad to answer any questions you and the members of your committee may have.

DEPARTMENT OF THE TREASURY
Administering the Public Debt

Revised Fee Structure
Issuing and Paying Agents
FY 1981

Fee Category	Old Rates	New Rates	Increase
ISSUES			
I. Payroll			
A. Financial Institutions			
- Computer inscribed	$.10	$.13	$.03
- Other inscribed	.30	.32	.02
B. Companies, State and Local Government	.10	.10	-
C. Issues on Conversion	.05	.05	-
II. Over-the-Counter	.70	.85	.15
Total Issues Cost [1]	$28,670,000	$32,083,000	$3,413,000
REDEMPTIONS			
A. Redemptions	$.30	$.34	$.04
B. E/EE's exchanged for HH's	.30	.50	.20
Total Redemptions Cost [1]	$41,661,000	$46,616,000	$4,955,000
TOTAL FEES COSTS	$70,331,000	$78,699,000	$8,368,000

[1] Cost increase reflects higher fees paid for only three quarters in FY 1981.

TREASURY-BILL ACCOUNTS

Question: Can you provide an indication of the growth in individual Treasury-bill accounts?

Answer: The following summarizes the growth of Treasury-bill accounts maintained by the Treasury:

Number of Book-Entry Accounts Outstanding

	No. of Accounts	Total Investment Amount ($000)
September 30, 1977	6,690	$182,110
December 31, 1977	19,429	$491,125
March 31, 1978	23,796	$564,515
June 30, 1978	33,322	$751,110
September 30, 1978	46,550	$910,960
December 31, 1978	58,164	$1,154,645
March 31, 1979	75,952	$1,375,640
June 30, 1979	102,977	$1,913,295
September 30, 1979	203,102	$3,672,740
December 31, 1979	291,169	$5,223,464
March 21, 1980	377,435	$6,085,450
April 4, 1980	408,257	$6,228,940

BIOGRAPHY OF RICHARD L. GREGG

Richard L. Gregg was appointed Assistant Commissioner (Financing) on July 1, 1979.

Mr. Gregg was born June 29, 1944 in Pierre, South Dakota. He received a bachelor of arts degree from the University of South Dakota in 1969, a master of public administration from George Washington University in 1971, and a law degree from George Washington University in 1977.

His government career began in 1970 with the Bureau of Government Financial Operations. While at that Bureau he worked in the field of banking and cash management. In 1976 he joined the Bureau of the Public Debt as technical assistant to the Commissioner, and was appointed Director of the Division of Financing in 1977.

He married the former Connie Laber in 1970. They have two sons, and reside in Springfield, Virginia.

STATEMENT OF AZIE T. MORTON

Mr. Chairman and members of the Committee, it is a pleasure for me to be here today with my colleagues to present the 1981 appropriation request of the United States Savings Bonds Division.

Before discussing our 1981 request, we would like to tell you about some important changes that have recently taken place in the Savings Bonds Program. On January 2, 1980, the new United States Emergy Savings Bonds Series EE went on sale in banks and other financial institutions and through the Payroll Savings Plan. The new bonds pay an interest rate of 6-1/2 percent at five years with a 1/2 percent bonus when held to maturity of eleven years. Present owners of Series E Bonds will also receive a 1/2 percent bonus if they hold their bonds for eleven years after January 2, 1980. Bonds held for less than that period will continue to pay the current interest rate of 6-1/2 percent.

The new Series HH Bond was also introduced on January 2, 1980, and will pay a level 6-1/2 percent from day of issue, rather than a graduated scale as does its predecessor the Series H Bond.

Series E and H Bonds were withdrawn from sale at financial institutions effective December 31, 1979. Series E Bonds will continue to be sold on the Payroll Savings Plan through June 30, 1980. Currently, we have over 41,000 payroll savings outlets, all of which must be converted to the EE bonds by June 30, as no E bonds may be issued after this date.

In our introductory statement last year we discussed the features of the new EE bonds, but we thought it worthwhile to touch lightly on some of the new features again. The purchase price is one-half of the face value, for example, a $100 face value bond sells for $50. The lowest available denomination is $50 face value, and the other denominations are $75, $100, $200, $500, $1,000 $5,000 and $10,000. The annual limitation on purchases at issue price is $15,000 in contrast to the former limitation of $7,500. The annual limitation on HH bonds has been increased from $10,000 face value to $20,000 face value.

With these changes, Treasury's commitment to the Savings Bonds Program as a vital link in its debt management program has been renewed and strengthened. Our program will also become even more cost effective. The increase in the minimum denomination to $50 reduces the number of bonds issued in relation to dollars borrowed, and makes it possible to reduce the volume of records maintained. The minimum retention period has been lengthened from two to six months to encourage serious savers to hold their bonds and thus reduce Treasury borrowing costs.

The environment for selling and maintaining a large outstanding balance of savings bonds was not good in FY 1979 and it is deteriorating even further in FY 1980. Primarily, very high competitive interest rates for 6-month and 30-month Money Market Certificates, as well as Treasury bills, notes, and bonds have resulted in substantial disintermediation from savings bonds and lower interest bearing savings accounts. In addition, uncertainty in economic conditions and inflation have caused a reduction in the general savings rate with resultant decline in savings bond sales and increases in savings bonds redemptions.

Fiscal year sales of savings bonds have reached $2.5 billion as of the end of February - down 18 percent from the same period last year. Redemptions of savings bonds are at record breaking levels, $5.3 billion as of February - up 63 percent from last year.

The 1980's provide us with a challenging opportunity to help build confidence in our country's future. By meeting this challenge successfully, we can contribute to the well-being of our country in several important ways. One, we provide a safe and convenient means of saving for employees. The Payroll Savings Plan offers a disciplined method of accumulating savings through regularly setting aside small sums each payday. Two, we contribute to the sound financial management of the public debt. Savings bonds have traditionally been the most stable part of the privately-held portion of the debt. And three, by actively involving almost 560,000 unpaid volunteers in the program, we provide a rare opportunity for these citizens to combine personal interest with significant service to their country.

The appropriation request for fiscal year 1981 provides for average employment of 445 and totals $15,799,000, a net decrease of $8,000 below the Proposed Authorized Level for 1980. We are requesting $341,000 for two program increases and $518,000 for increases necessary to maintain the current levels of operation. Non-recurring costs and other savings result in a decrease of $824,000, essentially due to several one-time only costs of introducing the new bonds in 1980 and $43,000 due to consolidation and reduction of space.

We are requesting a program increase of $200,000 for the Sales activity. Introduction of the new bonds in 1980 when coupled with a deeper market penetration in 1981 is expected to create a greater demand by payroll savings outlets for printed consumer and informational materials. Also, some informational materials will need to be expanded because of the public's unfamiliarity with the new bonds. The additional funds will permit us to procure a sufficient quantity of printed materials to meet consumer requirements and to fully explain to the public the features and benefits of the new bonds.

One other program increase in the amount of $141,000 is requested for the National Promotional Materials Center in Chicago. The efficiency and productivity of the Center would be enhanced by effecting several capital and management improvements. With the additional funding, we would establish a rental teletype system linking the Center with the District, Regional and Headquarters offices; commission a study of the long term needs of the Center; consolidate space from two locations into one, and purchase a word-processing machine. It is expected that these improvements will enable us to make better use of existing manpower by transferring five permanent positions from the Center to the Sales activity.

We also have a supplemental request of $372,000 to cover the civilian and Wage System pay increases of fiscal 1980. The total cost of the pay increases is $631,000. Through delays in filling vacancies and curtailment of travel and transportation we will be able to absorb $259,000 of this amount.

Mr. Chairman and members of the Committee, this concludes my prepared statement. We will be happy to answer any questions that you may have for us, and with your permission, we have some sales charts that we would like to have inserted in the record.

SUMMARY STATEMENT

Mr. HINTGEN. Mr. Chairman and Senator Schmitt, I would like to give you a brief statement in support of our appropriations request, in addition to the one which will be part of the record.

FISCAL YEAR 1980 SUPPLEMENTAL REQUEST

We are requesting a supplemental appropriation for 1980 of $26,174,000. Of this, $23,558,000 is for program increases and $2,616,000 is to cover the October 1979 pay raise.

The program increases are necessary because of the impact of record high interest rates on both of our major programs. The savings bond program is the victim of massive disintermediation as owners cash their bonds in record numbers and reinvest the proceeds to take advantage of the higher rates available in a variety of other investments, including Treasury marketable issues.

On the other hand, we are almost overwhelmed by the number of investors purchasing these marketable issues, and particularly by individuals who are attracted to the Treasury bill accounts maintained in book-entry form by the Bureau.

The major portion of the supplemental funds—$23,188,000—is required to permit us to meet our contractual commitment to pay a fee of 30 cents for each bond redeemed by a financial institution serving as paying agent.

In the first 6 months of this fiscal year, redemptions were 49 percent higher in terms of pieces processed, which is our workload measure, than in the corresponding period of the preceding fiscal year.

We are also requesting $134,000 and 15 average temporary positions to provide personnel to process this unprecedented workload.

The impact of high interest rates on marketable issues is reflected in the increased number of registered and book-entry accounts maintained by the Bureau.

On March 31 we had 393,000 book-entry Treasury bill accounts in the amount of $6.16 billion. That amount is 417 percent higher than 1 year ago, and it has been increasing at the rate of about 10,000 a week.

We are also requesting $236,000 and 21 average temporary positions to deal with this marketable workload.

FISCAL YEAR 1981 APPROPRIATION REQUEST

For 1981 we are asking for an appropriation of $196,625,000 to carry out the responsibilities of the Bureau of the Public Debt and the Savings Bonds Division. This is $13,015,000 below the proposed authorized level for 1980. Program increases in 1981 amount to $10,012,000. The net effect of other increases and decreases necessary to maintain current staff levels is a decrease of $23,027,000. No new positions are included in the request. I would like to emphasize the fact that the request does not include either the funds or the positions that are covered in our 1980 supplemental request.

We have an austere 1981 budget that is based on two assumptions. The first is that economic conditions will improve and that this improvement will result in a substantial reduction in the current rate of inflation as well as in the average interest rate paid for Treasury market issues. The second assumption is that these improved economic conditions will lessen the Bureau's workload by drastically reducing the present level of individual participation in Treasury marketable offerings and by lowering the unprecedentedly high volume of savings bond redemptions we are currently experiencing.

ISSUING AND PAYING AGENT FEES

There are two items I might refer to specifically in the 1981 request. One is the request for $8,368,000 to implement a higher fee schedule for savings bond issuing and paying agents. This request is the result of a study that was made, and it is designed to bring fees more nearly in line with the agent's actual costs for handling these transactions.

We have for the record a table that shows the current proposed fees in detail and the effect on the appropriation.

FEDERAL RESERVE BANK REIMBURSEMENTS

The second item I might mention is we are requesting a total of $34,387,000 to reimburse the Federal Reserve Banks for their services as fiscal agents in the conduct of public debt transactions. This includes an increase of $1,303,000, attributable to normal cost and volume factors.

Senator CHILES. Let me ask you something about that. My understanding is that we are talking about reimbursement to the Federal Reserve System, that further reductions of this are being considered through reprograming. At one time last month the entire amount was considered as a cut by the President. As the Federal Reserve System turns in billions of dollars each year to the Treasury, why don't we eliminate this payment to the Federal Reserve and ask them to process the Treasury bonds without charge?

Mr. HINTGEN. There are several reasons why we feel——

REIMBURSABLE PAYMENTS TO THE FEDERAL RESERVE BANKS

Senator CHILES. Why didn't Treasury decide not to offer this $34 million as a savings?

Mr. HINTGEN. The reimbursable system has been in effect since 1917. We feel strongly that it is the proper way to handle this kind of operation.

First of all, eliminating reimbursements has no net impact on the budget because receipts would be reduced to the same extent as expenditures. But the basic reason for the reimbursement system is that it permits us to state in a single appropriation the entire cost of administering the public debt. It subjects that amount to prior review by the Department and, more particularly, by the Senate committees and the House committees through the appropriations process. It also confirms the principal and agent relationship which exists between the Treasury and the Federal Reserve System and permits us to establish requirements consistent with public debt policy, public debt management policies which the banks then carry out.

From an accounting standpoint, I think it is more appropriate to reflect both the receipt and expenditure side of this activity.

Senator CHILES. It seems to me we are talking about where we are going to place the burden. Right now the burden is placed on the taxpayer who pays into the general revenue for that. Why shouldn't the burden be placed on fees earned by the Federal Reserve System, which are $10 billion in excess of expenditures?

Mr. HINTGEN. It is true, of course, that all of the excess earnings come back to the Treasury. So there is no burden on the taxpayer for this system.

Senator CHILES. I understand.

Mr. HINTGEN. So it doesn't really have any impact on the budget. If you eliminate the reimbursements, you eliminate your oversight of reimbursements and that $35 million worth of public debt expenditures.

Senator CHILES. Mrs. Morton?

SUMMARY STATEMENT OF MRS. MORTON

Mrs. MORTON. Mr. Chairman and Senator Schmitt, the Savings Bonds Division appropriation request for fiscal year 1981 provides for average employment of 445 persons and totals $15,799,000, a net decrease of $8,000 below the proposed authorized level for 1980. We are requesting $341,000 for two program increases and $518,000 for increases to maintain the current levels of operation.

We are requesting a program increase of $200,000 for the sales activity. This is a result of the introduction of the new bonds in 1980 which, when coupled with a deeper market penetration in 1981, is expected to create a greater demand by payroll savings outlets for printed consumer and informational materials.

The other program increase in the amount of $141,000 is requested for the National Promotional Materials Center in Chicago.

We also have a supplemental request for $372,000 to cover the civilian and wage system pay increases of fiscal 1980. The total cost of those increases is $631,000, but we have been able to absorb $259,000 of that amount.

I have a fuller statement for the record.

Senator CHILES. Your full statement has been included in the record. Your principal role, as I see it now, is to go out and try to sell these bonds or try to promote our savings bonds program. That breaks down as being one of your principal roles. I know that it is a pretty tough role right now when we see the amount of bonds we are having to cash in.

I spoke with the Secretary yesterday about the program. He tells me that they are looking now at making a proposal to have a sliding interest rate or a rate that you would be able to change. I think you are certainly going to have to do something like that.

QUESTIONS RAISED BY GRAY PANTHERS

I understand the Gray Panthers have complained to the Federal Trade Commission about the savings bond program operated by the Bureau. We understand essentially their concern is that the Bureau is spending public money to promote the bonds which give only 7 percent. They complain it is an improper use of public moneys as there are better investments available at similar risks.

What can you tell us about those complaints? How do we respond to those charges?

Mrs. MORTON. Well, the attorney for the Gray Panthers filed a complaint indicating that the rate of interest paid on savings bonds was much too low and it was hazardous to the welfare of the Gray Panthers and that in any advertising we should so state that.

We consider that somewhat frivolous. We are aware that the interest rate is low and, as you have indicated, the Secretary has asked for that to be lifted. Our activity last year generated $7.3 billion in revenue. The rate this year has not been that high. Redemptions have been heavy. We have in some instances credited the program with being successful in that people have bought bonds and are now redeeming them and going into other kinds of funding. We think that is a plus.

Senator SCHMITT. Mr. Chairman, would you yield just briefly on that point?

Senator CHILES. Yes.

Senator SCHMITT. I would not call the issue raised by the Gray Panthers frivolous. The expression of it might be facetious to some degree.

Mrs. MORTON. That is what I meant, Senator.

Senator SCHMITT. It is not a good investment. It is a patriotic investment. I have made them for years. I am not currently making them in those bonds for other reasons, mainly because I am giving away so much of my salary in scholarships. But it is still not a good investment. But in a way you are sort of putting them on. It is a con game.

Mrs. MORTON. Senator, I agree with you. It is not a good investment. But it is a good savings program. We encourage people to save. Once they have saved large enough amounts, they can invest in something else.

The average individual who buys a savings bond saves about $3.50 a week until they get a $25 bond. There is no other program where an individual can do that.

Senator SCHMITT. That is a good point.

Senator CHILES. I think we still need to do something about that interest rate because it is not really fair when the Government is paying what it is paying for money in all of these other areas to again get that person who is a small saver and can't put aside that amount of money and then have them put aside that amount of money and they do not get a better return on that, because inflation is really eating away at those savings.

Mrs. MORTON. I couldn't agree with you more.

Mr. HINTGEN. May I add something, sir? The Secretary testified this morning before the Senate Finance Committee, and in his testimony on the debt ceiling he has specifically again asked that the 7 percent rate ceiling on savings bonds be repealed.

Senator CHILES. We will have a few more questions that we will submit to you for the record. We will let this conclude your testimony.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

Federal Reserve Banks

Question:	As the Federal Reserve turns in billions of dollars each year to the Treasury, why don't we eliminate this payment to the Federal Reserve and ask them to process Treasury bonds without charge? Why did Treasury decide not to offer the $34 million as a savings?
Answer:	The Treasury has strongly supported the principle of reimbursing the Reserve Banks for services provided in connection with public debt activities. This reimbursement principle permits the Treasury to state in a single appropriation the total cost of administering the public debt. It subjects all of the component costs to prior Departmental and Congressional review and oversight through the appropriation process. The reimbursement system also strengthens the agency - principal relationship between the Treasury and the Federal Reserve System by enabling the Department to establish requirements for conducting public debt functions which are carried out on a reimbursable basis. Discontinuing reimbursements to the Federal Reserve Bank would serve no constructive purpose. Budget outlays for such reimbursements are exactly offset by budget receipts from the Federal Reserve System. The real loss would occur in sacrificing the oversight accomplished through the appropriation process over a sizable portion of the administrative costs of administering the debt. Ultimately, such a move could weaken the Treasury's control over the conduct of public debt activities, with no real effect on the budget.

Paying/Issuing Agent Fees

Question:	When were the fees for issuing and paying agents last changed? What is the percentage increase in fees? Who negotiated the increase? Do the fees cover the full cost of the service?
Answer:	First it should be made clear that the FY 1980 supplemental request for paying agent fees results from an increase in the number of savings bonds expected to be redeemed. It is not a request to pay agents a higher fee. The Bureau has submitted supplemental proposals amounting to $23,188,000 in FY 1980 to compensate paying agents for the high volume of bonds that are being redeemed. The 1981 budget proposes an increase in the fee schedules for both issuing and paying agent fees. As background, it should be noted that paying agent fees were increased and issuing agent fees initiated effective November 1, 1978, in connection with the implementation of the Treasury Tax and Loan (TT&L) Program. The issuing agent fees served to offset the loss of interest earnings which financial institutions formerly received

on Treasury tax and loan accounts. At the time these fee rates were established, the institutions expressed concerns that the rates (based on a 1974 study) of costs were insufficient to cover their expenses. As a result, the Treasury agreed to re-examine the fee schedule.

The Bureau cooperated with the American Bankers Association in developing a questionnaire which was used by ABA to survey financial institutions in an effort to determine their costs in issuing and redeeming savings bonds. The results of the survey indicated a need for upward revision in schedules. The Bureau reviewed the survey data in detail and determined to its satisfaction the fee increases which would be reasonable. The increases proposed in the FY 1981 budget are conservative in keeping with the need for budget austerity but are within the range indicated by the survey results. No negotiation, as such, took place with regard to our determination of the appropriate fee scales. The proposed increases provide for approximately a 16% increase in costs.

Question: In view of the interest to balance the 1981 budget, what would be the effect of not granting the request?

Answer: The success of the Savings Bond Program depends to a considerable extent on Treasury's ability to maintain a widespread network of agents to provide reasonably convenient issuing and redeeming services to savers. The Program has long served as a stable and relatively inexpensive source of borrowing for the U. S. Government. Inability to provide equitable compensation to our issuing and paying agents could lead to their dissatisfaction with and possible withdrawal from the Program. A significant reduction in the size or dispersion of the agent network could seriously harm the Program. Funds not obtained through the sale of savings bonds would have to be raised on the open market at a higher rate of interest, thus negatively impacting efforts to balance the budget.

It should also be noted that the Government, through the TT&L program, is realizing revenues which exceed the amount paid to agents as fees. In the 11 months of FY 1979 for which the TT&L program was in effect, gross interest earnings on Treasury tax and loan balances held by financial institutions totaled $646 million. Offsetting costs, in the form of fees paid by the Bureau of the Public Debt and the Bureau of Government Financial Operations, totaled only $81 million.

Question: Isn't there a benefit to the institution to offer these Treasury bond services to their customers?

Answer: It may be that the provision of savings bond issuing and paying services is, for most financial institutions, simply a part of being a "full service" institution in a competitive market. However, there are considerable costs involved in providing this service to the Treasury. Since the agents are prohibited by Treasury from charging their customers for these services, as a matter of equity we compensate the agents for services rendered.

Treasury Bill Workload

Question: According to a recent post story (1/20/80), in October of 1978 the Bureau had 45,000 active individual Treasury bill accounts worth $942 million and a year later the Bureau had 225,000 accounts worth $3.4 billion. The post story recounted several cases of missing repayment checks and long delays for individuals to receive their repayment checks. What caused the enormous growth in workload? What is the current status of this situation?

Answer: All of the incidents in the newspaper article referred to above have as a principal cause the historically high interest rates which have generated enormous growth in workloads in the Bureau. Interest rates on 13-week Treasury bills increased significantly from 9.89% in March 1979 to 17.49% in March 1980. These record high interest rates have attracted thousands of additional small investors to the purchase of Treasury bills, which are risk-free and exempt from state and local taxes. Treasury bill accounts maintained by the Bureau are additionally attractive because there is no service charge or transaction fee.

Accounts held at the Bureau have increased from 76,000 for $1.4 billion in March 1979 to 393,000 for 6.2 billion in March 1980. As of April 11, 1980, we are maintaining over 428,000 accounts involving $6.4 billion.

This unprecedented explosion in workload, for which no budgetary provision could be made, created severe problems in establishing and servicing bill accounts. There have been delays in mailing checks in payment of the discounts on new bills or the face amounts of bills redeemed. There have also been cases in which individual checks have been delayed because of processing errors or mail delivery problems. Although regrettable, these are to be expected in the face of the high workloads, the severe time constraints involved, and the limited resources available.

Computerization of the bill activities has been expanded. Supplemental funding has been requested. Other initiatives are now underway and are expected to reduce the problems involved in processing the accounts expeditiously.

SUBCOMMITTEE RECESS

Senator CHILES. The subcommittee will now stand in recess until 10 a.m. tomorrow morning.

[Whereupon, at 12:25 p.m., Wednesday, April 16, the subcommittee was recessed, to reconvene at 10 a.m., Thursday, April 17.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1981

THURSDAY, APRIL 17, 1980

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, D.C.

The subcommittee met at 10:08 a.m., in room 1114, Everett McKinley Dirksen Senate Office Building, Hon. Lawton Chiles (chairman) presiding.

Present: Senators Chiles, DeConcini and Schmitt.

Also present: Senators McClure and Domenici.

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

STATEMENT OF JOHN F. SHANNON, ASSISTANT DIRECTOR

ACCOMPANIED BY:
ROBERT KLEINE
RICHARD REEDER

CIGARETTE BOOTLEGGING

Senator CHILES. Good morning. The testimony of our several witnesses this morning will focus on the problem of cigarette bootlegging. With passage of Public Law 95-575 any trafficking in excess of 60,000 contraband cigarettes is a Federal offense and enforcement of this law has been assigned to the Bureau of Alcohol, Tobacco and Firearms.

The original estimates made in 1975 by the Advisory Commission on Intergovernmental Relations (ACIR) showed that in excess of $337 million was being lost each year by 34 States because of the bootlegging problem. The Bureau of Alcohol, Tobacco and Firearms recently reran the ACIR model with current data. This showed that all States except Florida and Massachusetts were losing less revenue due to the cigarette bootlegging problem in 1979 than they were in 1975. The losses for Florida, however, have increased from an estimated $36 million in 1975 to approximately $43 million in 1979. The losses for the State of Massachusetts have increased from approximately $12 million in 1975 to $21 million in 1979.

In a general sense we are pleased to see the improvement made by most of the States. However, the worsening of the problem in Florida and Massachusetts is of growing concern to this committee.

In order to learn more about this problem from the State perspective, the committee is delighted to have the Director of the Division of Alcoholic Beverages and Tobacco, Mr. Charles Nuzum, with us today. We will also be receiving testimony from ACIR and the Bureau of Alcohol, Tobacco and Firearms on this problem.

BUDGET REQUESTS

Subsequent to our discussion of cigarette bootlegging, we will hear testimony in support of the appropriations requests for the Bureau of Alcohol, Tobacco and Firearms, the Federal Law Enforcement Training Center, and the Secret Service. The combined requests for these agencies in fiscal year 1981 is $315,285,000.

We will begin our hearings this morning by receiving testimony from Mr. Wayne Anderson of the Advisory Commission on Intergovernmental Relations.

I understand Mr. Anderson is sick and Mr. John Shannon, the Assistant Director, will be giving that testimony.

PREPARED STATEMENT

Mr. Shannon, the committee has your budget request for $1,771,000 for 1981 and the 1980 supplemental request of $63,000 before us. We will put your statement in support of these requests in the record, and we have several questions for you to answer for the record regarding these requests.

[The statement follows:]

STATEMENT OF WAYNE F. ANDERSON

My name is Wayne F. Anderson. It has been my privilege to serve as Executive Director of the Advisory Commission on Intergovernmental Relations since 1974.

ANALYSIS OF FY 1981 REQUEST

The Commission believes that tight budgets should be the rule rather than the exception, and our Fiscal 1981 request again reflects that philosophy. The amount requested for FY 1981 is 5.5% greater than the amount appropriated to date and requested for pay cost supplementals for FY 1980; a figure that represents less than one-half the inflation rate. Over the last three years, Fiscal Years 1979 to 1981, our budget has increased only 6.5%, an amount that is far less than was required to fund pay cost supplementals and only one-fourth of the inflation for that period.

Fixed costs account for over 87% of our request. In absolute dollars, the amount over which we have any real measure of discretion has remained essentially stable in the $200,000 - $250,000 range, but in terms of buying power it has declined significantly over the past five years. We have endeavored to do as much or more work on fewer dollars by finding savings and efficiencies. Over the past year we have achieved such savings by severing all administrative ties with the General Services Administration, going to term contracting with the Government Printing Office, and installing postage metering and mailing equipment in our offices. While these savings initially began to appear this year, the full impact is indicated in the 1981 request.

Beyond this, I assure you that our staff guards against grade creep, monitors its spending so as to preclude unforeseen disruptions in our operations, and reverts whatever balance it can to the

Treasury each year. I, therefore, can conscientiously say to you that our FY 1981 request represents the true needs of the Commission to maintain its current service level.

ACIR'S WORK PROGRAM

In the interest of brevity, I will only name titles of ACIR's major research and implementation projects.

Work Completed in FY 1979

Staff research was completed and the Commission acted on recommendations on the following subjects in FY 1979:

--Citizen Participation - This study, which was mandated by the Congress, focused on the 155 citizen participation federal requirements attached to federal aids.

--Housing Mortgage Bonds

--State and Local Pensions - This study explored what types of federal regulation, if any, are desirable.

--Interstate Tax Competition

--Alternative Methods of Restraining Federal Taxing and Spending

--Reenactment of General Revenue Sharing

The Commission also heard a staff report comparing how four countries -- the United States, Canada, West Germany, and Australia -- try to achieve certain fiscal objectives. It will be published later this year.

Implementation Priorities

The Commission's implementation activities gave priority to the following work:

--Federal Grant Reform - Our primary efforts here related to working with the Senate on the Federal Assistance Reform Act, S. 878 and H.R. 4504.

--Financial Management Capacity Building - Under a HUD grant, ACIR is in its second year of working with state governments to widen knowledge and acceptance of 19 types of financial management improvements.

--State Community Assistance Initiatives - This new report inventories the increasing activities by states in the community development and economic development field.

--Indexation - An update of the Commission's 1976 report on income tax indexation presents the experience of six states that have adopted indexation recently.

To broaden awareness of an intergovernmental subject that has grown in complexity and importance in recent years, the Commission also convened its first Conference on Federal Grant Law on December 12, 1979.

Current Work

Looking ahead, our current work that will consume our efforts throughout FY 1980 consists primarily of five projects: (1) The Federal Role in the Federal System, a study of which functions are appropriate or inappropriate for the federal government; (2) State and Local Functional Assignments; (3) Future Forces Affecting American Federalism: (4) Payments

In-Lieu of Taxes for Federal Real Property; and (5) Local Government Finance in the 1980's. The first four were mandated or requested by the Congress.

I trust that this listing of our work makes it appear that we are as busy as our small agency feels it is. Given the fact that so much of our work and competence does deal with public finance and the federal aid system, the fiscal austerity outlook as we enter the 1980's is that our work may be even more needed and valuable than it has been in the past.

Mr. SHANNON. Thank you, Mr. Chairman. I am John Shannon, the Assistant Director of ACIR, and I am accompanied this morning by Robert Kleine and Richard Reeder. Mr. Kleine directed the ACIR study of cigarette bootlegging we completed in 1976. Mr. Reeder assisted him with the statistical analysis.

We are happy to have this chance to testify concerning our estimates of the extent of cigarette bootlegging and State revenue losses. As agreed with your staff, we have submitted a longer, technically more precise statement on just how we developed our estimates, and we request that it be included in the record so that we can now present a shorter oral description of our work.

This morning I will make a very short covering statement and then Mr. Kleine, who directed the statistical modeling, will amplify on my remarks.

Senator CHILES. All right, sir. Your statement in full will be included in the record.

[The statement follows:]

STATEMENT OF WAYNE F. ANDERSON

My name is Wayne F. Anderson. I am the Executive Director of the Advisory Commission on Intergovernmental Relations. Appearing with me are Robert Kleine and Richard Reeder, both formerly on the ACIR staff, who were the principal investigators and authors of ACIR's 1977 report, Cigarette Bootlegging: A State and Federal Responsibility.

Mr. Chairman, we understand the need for accurate state-by-state estimates of cigarette smuggling. Our report used one method to obtain such estimates. Our method was the best we could provide our Commission members, given the scope of our study. We recognize now as we did at the time that our estimates have their limitations. For this reason, we are pleased to have this opportunity to explain the methodology underlying our estimates, the strengths and weaknesses of these estimates, and their relevance to the case of the state of Florida.

Let me launch the discussion of ACIR's cigarette revenue loss estimates by noting that we began doing this analysis with one major objective in mind--to determine whether available cigarettte sales data supported the contention of many state law enforcement officials that interstate cigarette bootlegging had become a significant "nationwide" problem. Evidence and testimony already existed from other sources indicating that cigarette smuggling had become a significant problem in several different sections of the country, including the Eastern seaboard, the Midwest, and, to a lesser extent, the Northwest. ACIR needed a statistical analysis using data from all fifty states to determine if a "national" problem existed. The central findings of our statistical analysis did in fact support the claim that a significant national problem existed in 1975.

The individual state revenue loss estimates were subsequently constructed to assist in developing a scenario for how the individual states fit into this nationwide smuggling pattern. As such, these estimates, the subject of this hearing, were a by-product of our study. The revenue loss estimates, expressed as a percent of total state cigarette revenue, were only one of five factors used in classifying the fifty states into four broad categories: those with serious cigarette tax evasion problems, those with moderate problems, those with minor or no problems, and those which benefit from tax evasion. The other factors considered in this classification scheme included that Batelle-LEAA Survey of state law enforcement perceptions of the magnitude of bootlegging problems, the state's per capita sales relative to the U.S. average, the state's tax rate relative to the tax rates of bordering states, and the state's tax rate relative to other low tax states in the region.

In some cases where evidence from the Batelle-LEAA Survey and other sources conflicted with the revenue loss estimate, the loss estimate was judgmentally accorded a secondary role in the state's classification. For example, Illinois, Massachusetts, Ohio, Michigan and Georgia were classified as having somewhat greater smuggling problems than the loss estimates indicated. Conversely, tax evasion problems in Alabama, Maine, and Iowa were downgraded compared to the loss estimates for these states. For the most part, however, the loss estimates roughly corresponded to the other available evidence, so that we found the loss estimate to be a reasonable indicator in classifying the states according to the degree of the cigarette tax evasion problem.

It should be stressed, however, that because of its nationwide focus, the ACIR model could not be designed to assure accurate estimates for the revenue losses of individual states. ACIR's loss estimates should therefore be used with caution and in conjunction with other evidence when evaluating any individual state's cigarette smuggling problem.

The ACIR Estimating Model

The theory behind our estimating model is as follows. As a state's tax on cigarettes rises, the potential gain to be made from smuggling low tax or untaxed cigarettes into the state rises. This smuggling activity should be detectable by examining the state-to-state variation in tax paid cigarette sales. Other things being equal, if cigarette tax evasion is generally prevalent, most high tax states should have lower than average per capita cigarette sales for which the state tax has been paid, reflecting the substitution of bootleg cigarettes for tax paid cigarettes sold in the state. Low tax states should exhibit higher than average per capita sales since they should be sources for smuggled cigarettes going to high tax states. The object of our analysis was therefore to test the available data for the existence of a substantial inverse relationship between state and local cigarette tax rates and tax paid per capita cigarette sales. If data on the fifty states suggests such a relationship exists for the nation as a whole, then this would support the contention that a national problem exists.

A common statistical method for testing such a relationship is simple correlation analysis, which measures the relationship between two variables. But, complicating this test, is the need to account for other important factors which can be expected to give rise to variation in per capita cigarette sales among the fifty states. Some of these other factors are tax related and thus affect cigarette smuggling; others are non-tax factors. Because of these complications, multiple regression analysis represents a better technique than simple correlation.

Multiple regression is designed to test the dependency of a given variable upon a number of independent factors. In our case, we desired to test (or regress) the dependency of 1975 state per capita cigarette sales upon several tax and non-tax factors. Beginning with data on each state for fiscal year 1975, the regression estimated separately the impact of each factor upon per capita sales. Thus, we estimated that in 1975, one could expect any given state to experience a reduction in cigarette sales of 3.6 packs per capita for every one cent increase in the state's cigarette tax, other factors being equal. The regression analysis provided similar estimates for the other factors as well.

One of the strengths of regression analysis is that it can verify the existence of nationwide tendencies given data from each of the fifty states. In this case the 3.6 pack per capita sales decline per one cent increase in state cigarette tax is an estimate of a nationwide tendency associated with all fifty states. The regression method also provides a basis for determining the accuracy of this general tax impact estimate. In this case, we can say with 95 percent confidence that the true tax impact on per capita cigarette sales, nationwide, should be between 2.9 packs and 4.4 packs. This allows us to make general conclusions about cigarette tax evasion with a fair degree of confidence.

A weakness of regression analysis is that the estimates tend to be much less accurate for particular situations, such as the case of an individual state in a particular year. I will return to this weakness later on when I discuss ACIR's individual state revenue loss estimates.

First, let me identify the various tax and non-tax factors examined in our regression analysis. Obviously, the amount of the state's tax on cigarettes is of key importance in explaining cigarette tax evasion. In addition, other tax factors related to special types of cigarette smuggling were included in our analysis. For example, we used a border state factor to identify high tax states with low tax states on their borders. This situation should lead to smuggling, hence, it should have an impact on per capita sales attributable to cigarette bootlegging in both states.

A local tax factor was included to identify states where localities are allowed to tax cigarettes. This tax add-on to the state cigarette excise and sales taxes may be expected to create a concentrated target for cigarette smugglers and thereby reduce a state's per capita sales.

Two variables were employed to denote the special windfall profit situation the very lowest tax states enjoy from their being the principal source of interstate bootlegging. One variable treats New Hampshire, the lowest tax state in New England, as a special case. The second variable covers both North Carolina and Kentucky as the likely beneficiaries of much of the remaining interstate bootlegging traffic east of the Mississippi.

A number of non-tax factors cited in previous studies as affecting cigarette consumption were also included in the model. The percent of a state's population above age 18, we hypothesized, should be directly related to per capita cigarette sales. Similarly, states with large tourist trade, as measured by hotel and motel receipts per capita, can be expected to have higher per capita sales. Region and religion were tested as factors thought to be associated with attitudes toward smoking. In particular, people in western states have been found to smoke less than those in the east, and people adhering to Mormon or Seventh Day Adventists' beliefs refrain from smoking. Per capita income was entered as an influence since past studies had found a significant positive relationship between smoking and income.

None of these factors were used directly to produce cigarette smuggling loss estimates since we assumed they were mostly unrelated to tax evasion. They were nevertheless important variables in the regression analysis since they help to explain the overall variation of state cigarette sales, and thereby sharpen the estimate of anticipated consumption and the cigarette tax evasion associated with tax factors.

When both the tax and the non-tax variables were used in the model, the regression analysis accounted for 95 percent of the variation in per capita cigarette sales among the states, and all of the factors were found to be statistically significant. Most important was the large estimated effect of the state tax factor--a 3.6 pack decline in per capita sales for every one cent increase in the state's tax on cigarettes. In our judgment, this tax impact primarily reflects smuggling activity on a nationwide basis, as of 1975.

Accuracy of the Estimates

Several weaknesses in the regression approach carry through to the individual state loss estimates. First and foremost is the fact that not all of the 3.6 pack decline is due to cigarette tax evasion. Some reduction in sales is expected because cigarette smokers may cut back on smoking when cigarette prices rise. The regression procedure does not differentiate between the cigarette smuggling effect and this consumption effect. It only tells us the overall impact of the tax on cigarette sales. We concluded that the cigarette smuggling effect was the larger of the two because previous studies found that the consumption effect was quite small. The traditional wisdom, though not undisputed, is that cigarette smoking is a habit which is relatively unresponsive to changes in price.

In our judgment, the existence of this consumption effect did not compromise the overall conclusion that cigarette smuggling had become a significant national problem. Uncertainty over the exact magnitude of this effect, however, does create a high degree of potential error in the revenue loss estimates. The sensitivity of our estimates to this potential source of error was revealed in an analysis provided in the ACIR report. Based on this analysis, our assumed consumption effect resulted in a $337 million net loss figure for the U.S. as a whole. (See Table 1.) If, however, the true consumption effect is actually twice this size, the net loss figure falls to $144 million. If, in contrast to both of the foregoing situations, the true consumption effect is actually zero, i.e., people do not alter smoking habits because of changes in prices, then the net loss figure rises to $448 million.

Regression analysis does not tell us what tax differential would result in neither appreciable gainers or losers. It merely enables us to compute a state's smuggling loss relative to the loss it would incur if its tax was one cent higher or lower. To compute the magnitude of a state's smuggling loss or gain, we had to choose a tax rate at which we would expect neither gain nor loss, other factors being equal. Having no clear basis upon which to choose a break even tax rate a fairly arbitrary across-the-board adjustment to our loss estimates was required to obtain a reasonable break even point between winners and losers. This break even point was chosen so that for the fifty states the average smuggling gain or loss, in per capita sales, was zero. While we thought this was a reasonable assumption, it nevertheless introduces some additional potential for error in the loss estimates.

Regression analysis describes "average" impact and therefore when estimates of loss are made for particular states, their potential for error is enlarged. ACIR's individual state smuggling loss estimates were derived by multiplying each state's tax factors by their respective overall regression coefficients. After adjusting for the consumption effect and the break even point--both of which are subject to error as I have explained--individual state loss estimates, in per capita sales, are obtained. Thus, the potential error involved in applying regression coefficients to particular states may be added to the potential error from two other calculations entering into the loss estimates. There is no way to test the correctness of these loss estimates since they depend on uncertain assumptions and adjustments. Hence, my earlier note of caution to the effect that these estimates should be considered in conjunction with other evidence when evaluating the severity of any individual state's cigarette smuggling problem.

In addition to the methodological limitations inherent in these loss estimates, it is important to note that there is no way to distinguish the contribution of various types of cigarette smuggling to the estimates. States can lose cigarette tax revenue due to illegal over-the-road, or across-the-border smuggling, or through legal purchase of cigarettes at untaxed sources such as Indian reservations and military bases, or because of counterfeit stamping at the local source. Thus, the loss estimates do not represent interstate contraband in the legal sense of that term.

The Case of Florida

I would now like to focus on the specific estimate of Florida's. It presents special estimating problems. It's state cigarette tax rate is extremely high; in 1975, Florida's sales and excise taxes on cigarettes amounted to 20 cents per pack, the second highest tax rate in the country. Because of its unusually high tax, Florida is an obvious target for organized cigarette bootlegging, and the ACIR model estimated its revenue losses to be $35.7 million in fiscal 1975. The higher a state's tax rate, however, the more sensitive ACIR's loss estimate is to error related to the consumption effect. Sensitivity analysis revealed that Florida's revenue loss estimate ranged from $16 million to $52 million, depending on the presumed price consumption effect. In contrast, the same source of error produced much less uncertainty in states with a lower tax rate.

Florida has another unique problem which could lead to error in our estimate of its cigarette tax loss. The Bureau of Alcohol, Tobacco, and Firearms recently assisted state enforcement officials in an arrest where both drugs and contraband cigarettes were being smuggled together. This suggests that if persons are bent on smuggling either drugs or cigarettes, they may find it useful to do both simultaneously. Our estimates do not take into account this complementarity of organized crime activity, thus we may be underestimating Florida's loss somewhat, other things being equal.

After Florida's tax was increased to its present level, the Regulated Industries and Licensing Committee of Florida's House approved legislation to reduce Florida's tax by four cents, citing cigarette bootlegging as the reason for this action. Barry Kutun, sponsor of the bill, noted that "Florida is getting a reputation for being a major center of organized crime and one reason is cigarette smuggling." He claimed that the previous year's tax increase had added to the organized crime problem in Florida. Although the cigarette tax reduction was not enacted, consideration of such action indicates that Florida officials are acutely aware of the relationship between the cigarette tax and organized bootlegging.

Other problems encountered in estimating Florida's loss involve Florida's significant tourist trade, its extensive sales of cigarettes at military bases and Indian reservations, and its unique border situation. Our model attempted to account for the expected positive impact of tourism on per capita sales, but the data we had for this factor was not current. In a case like Florida, our difficulty in gathering current data on hotel and motel receipts may have helped account for our having estimated Florida's actual per capita sales by 8 percent for 1975.

Most of Florida's population lives in the southern portion of the state, far from the state border. Thus, even though Georgia and Alabama had lower cigarette tax rates (13 and 15 cents, respectively) than Florida in 1975, it is unlikely that casual smuggling from across the state border would have reduced Florida's per capita sales as much as was estimated by the ACIR model. The close proximity of much of Florida's population to tax exempt sources of cigarettes, including military PXs and Indian stores, however, may lead to a compensating error in the opposite direction from that related to the border state error.

Since 1975, Florida's total tax on cigarettes has risen to 24 cents per pack, the highest in the nation. One might expect that by achieving the highest tax in the nation, Florida may over time become the focus of an unusually large amount of interstate organized bootlegging which previously operated out of the Northeast. Inflation may prove helpful, however, in reducing this type of activity.

Although Florida's tax on cigarettes increased from 21 to 24 cents, or by 14% in nominal terms, it declined in real terms from 1975 to 1979. Over the same period, consumer prices rose by 29%. According to ACIR's model, such a decline in the real reward to cigarette smugglers may be expected to result in a slight reduction in Florida's per capita sales loss.

The Bureau of Alcohol, Tobacco, and Firearms (ATF) re-estimated the ACIR Model for 1979. These updated figures indicate that Florida's estimated per capita sales loss due to cigarette tax evasion has declined marginally from 21.3 packs per capita in 1975 to 20.9 packs per capita in 1979. Florida's 1979 estimated revenue loss has risen in nominal terms from $35.7 million to $43 million, reflecting the increased tax loss per smuggled cigarette pack. In real terms, however, the revenue loss has declined by 6 percent because the tax loss per pack, after adjusting for inflation, has declined.

Due to the potential error in both the 1975 and 1979 estimates for Florida's cigarette tax evasion, one cannot be certain whether Florida's problem is easing or worsening. Additional analyses more finely tuned to the particulars of Florida might produce improved loss estimates. In our study we showed how a time series regression approach could be used to identify the extent of cigarette smuggling problems in the states of California and Kentucky. A similar analysis could be made for the state of Florida using the time series regression method.

Other approaches involving surveys on smoking habits and casual smuggling practices might also aid in pinning down the extent and nature of Florida's cigarette tax evasion problem. In the end, though, cigarette smuggling will always be something impossible to measure with precision and confidence because it is illegal and there is no direct data on this activity.

General Oberservations

Let me conclude by making a few general observations on what is happening nationally, and what can be done to address the cigarette smuggling problem.

It is clear from the ATF estimates for 1979, and from other evidence, that cigarette tax evasion has subsided considerably since 1975. Using the same methodology employed in our study, ATF estimated that by FY 1979 cigarette smuggling revenue losses for the U.S. declined by $56.6 million. The drop is even greater if one adjusts for inflation. This significant change is corroborated by the casual observation that low tax states like North Carolina, Kentucky, and New Hampshire, which we identified as prime sources for interstate smuggling, have experienced marked reduction in per capita sales, and state seizures of contraband cigarettes have been on the decline since 1976.

Inflation may be lessening the profit potential from bootlegging. Most high tax states have exercised restraint by not raising cigarette taxes above the levels of the mid seventies. In the meantime, the price of gasoline, an important cost in smuggling, has risen dramatically.

The public has been made increasingly aware of the illegality and harmfulness of cigarette smuggling. The enactment of the federal contraband legislation was accompanied by considerable publicity. The evidence indicates that the turnaround in the cigarette smuggling trend seems to have begun in 1976, when proposed legislation began its course through Congress. ATF officials have cited the enactment of this federal legislation as causing many of the border cigarette stores in North Carolina to close down in recent months. James Tully, New York State Tax Commissioner, claimed that in his state "Bootlegging has all but completely terminated as the result of the federal cigarette anti-bootlegging law."

While this is a favorable trend, it could revert back to the previous worsening trend if high tax states act to raise taxes again. Indeed, this appears to have happened in the case of Massachusetts and New Hampshire. Massachusetts, a high tax state, raised its cigarette tax from 16 cents a pack to 21 cents a pack in 1975. In that same year, New Hampshire, the lowest tax state in New England, placed a cap on its tax at 12 cents per pack (previously it had indexed its tax to the price of cigarettes). If cigarette smuggling is ever to be controlled, high tax states must resist cigarette tax increases. It would also help if low tax states would consider indexing their cigarette taxes to inflation until their tax rates approach the national average.

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Mr. Chairman, if the members of the Committee have questions, we would be happy to respond to them.

TABLE 1
Estimated Gains and Losses[1] Under Three Elasticity Assumptions, Parametric Sensivity
(In Millions)

State	Gain or Loss (E_d = 0.00[2])	Gain or Loss (E_d = 0.24)	Gain or Loss (E_d = -0.80)
Alabama	$ -0.3	$ -4.0	$ -2.4
Alaska	0.3	0.2	0.0
Arizona	-4.2	-3.4	2.0
Arkansas	-6.9	-6.5	-3.4
California	-14.5	-16.0	-11.8
Colorado	1.5	0.3	-0.4
Connecticut	-22.3	-16.1	-6.6
Delaware	-0.3	-0.2	0.0
District of Columbia	0.6	0.2	-0.1
Florida	-51.8	-36.7	-10.3
Georgia	-2.6	-2.6	-1.8
Hawaii	NA	NA	NA
Idaho	0.7	0.3	1.3
Illinois	-27.7	-21.7	-12.2
Indiana	7.4	4.0	1.3
Iowa	-5.1	-4.0	-2.1
Kansas	-1.4	-1.6	-1.2
Kentucky[1]	15.4	13.3	10.2
Louisiana	-1.6	-2.1	-1.4
Maine	2.6	-2.1	-1.1
Maryland	-0.2	0.2	-1.2
Massachusetts	-15.7	-12.1	-6.6
Michigan	-6.3	-6.9	-5.1
Minnesota	-16.9	-12.2	-6.0
Mississippi	-1.1	-1.5	-0.6
Missouri	-6.9	-4.0	-2.8
Montana	-0.1	-0.5	-0.3
Nebraska	-2.0	-1.7	-1.1
Nevada	0.0	0.4	0.3
New Hampshire	11.6	11.3	11.2
New Jersey	-37.4	-30.0	-11.7
New Mexico	-1.1	-1.0	-0.5
New York	-105.7	-72.3	-32.1
North Carolina	19.5	18.6	14.0
North Dakota	-0.1	-0.2	-0.1
Ohio	-20.8	-16.9	-10.1
Oklahoma	-1.8	-1.2	-0.7
Oregon	2.6	1.5	0.6
Pennsylvania	-50.1	-35.9	-17.1
Rhode Island	-0.3	0.2	-0.1
South Carolina	3.1	1.4	0.8
South Dakota	0.0	-0.1	-0.1
Tennessee	-6.5	-7.8	-4.7
Texas	-60.3	-43.1	-30.0
Utah	0.9	0.3	-0.1
Vermont	1.2	1.0	1.0
Virginia	6.3	2.5	0.3
Washington	-16.7	-13.2	-6.2
West Virginia	-2.2	-1.8	-1.1
Wisconsin	-19.4	-13.6	-6.4
Wyoming	0.5	0.2	0.1
TOTAL (Net)	$-448.0	$-337.1	$-144.3

ains and losses are for 1975 total cigarette revenue including State and local cigarette tax plus State sales tax.
his assumption was also employed for estimating revenues resulting from uniform tax credit plan in Table 12.
urce: ACIR staff computation.

Mr. SHANNON. Thank you, sir.

From our written testimony and Mr. Kleine's oral testimony, certain highlights will emerge. There are four kinds of data that we have used but could not have solely relied upon in estimating cigarette bootlegging and revenue losses. We concluded that we had to develop a more precise statistical model to really do the job that was called for.

In our final report, we have published much of the data and described the revenue loss model so that others would be able to rerun the model or refine it as new data become available and other opportunities develop.

The Bureau of Alcohol, Tobacco and Firearms, as you know, has since rerun that model so as to update our 1975 estimates and produce their own 1979 figures. Mr. Kleine will be making a number of points concerning the strengths and the limitations of our model and our data.

EXPLANATION OF ESTIMATES

You will hear him say that there is not now and never will be any direct data on bootlegging per se, that the model nevertheless provides a basis for reasonable confidence about our estimates of the 50-State revenue loss. But I must concede that as you go down below the national level, as you handle each of the States, there is less confidence concerning the revenue loss for each of the individual States and that high tax States, such as Florida and Massachusetts, represent the toughest cases. There is no question on that score.

ACIR and other public policy research organizations, of course, must always be prepared to sustain their estimates, to show that they are reasonable, objective, and appropriate for public policymakers and not seriously misleading or wrongfully injurious to any party.

We also endeavor to minimize the likelihood that our work will be misrepresented, misinterpreted, or even misused.

With reference to these general statements on public policy research, our initial purpose was to determine the extent and the character of the cigarette bootlegging problem. When our studies sustained to our satisfaction that the problem was of serious magnitude, we moved on to develop alternative recommendations aimed at reducing or eliminating bootlegging and the related revenue losses.

As is ACIR's normal practice, we subjected our original research plan to review by knowledgeable persons and then we subjected the draft report to a group of critics. Through these two steps and through a public hearing on the report conducted by the Commission and through the year of the report's exposure leading to congressional enactment of the contraband law, our methodology came in for no severe criticism. In fact, I could put it more affirmatively; the methodology certainly was accepted.

There was, of course, general recognition that some measure of error could not be avoided. But we were generally credited with containing this error and disclosing its likely sources and underscoring again the limitations especially on a State-by-State basis.

We would acknowledge that when a particular State's estimated revenue loss is high, the estimate can generate the interpretation that there is more organized crime and weaker law enforcement than is the real world situation. Alternatively, it can generate hypotheses that the revenue loss is largely explained by more people quitting smoking.

ACCURACY OF FIRST STUDY

Our judgment is that our study, when considered in combination with all other public information on this subject, did not misrepresent the cigarette tax situation in any State. It demonstrated the need to improve research on this very difficult bootlegging problem in order to advance the understanding and the corrective, remedial actions that are called for.

We believe our means are responsibly suited to the ends that we identified. We also believe that our estimates and the methods laid a sound basis for the various recommendations adopted by our Commission. Their major recommendations called for a Federal contraband law, a cooperative Federal-State law enforcement effort, and for the States to moderate interstate tax differentials.

These recommendations in our view are well sustained whether you take the highest plausible revenue loss estimates or the lowest that can be inferred from our report. I must concede, Mr. Chairman, that in expressing these thoughts it is difficult not to sound defensive about our research, even though all of us associated with the study believe that we have completed a responsible and otherwise careful piece of public policy research that greatly illuminated the serious national problem and quickly led to corrective action that is succeeding in suppressing smuggling.

I would like now, if I could, Mr. Chairman, to turn the microphone over to my associate, Mr. Kleine, who will go into more detail on the statistical methodology. It will be a relatively short statement.

Senator CHILES. Very well. Mr. Kleine?

STATISTICAL METHODOLOGY

Mr. KLEINE. Thank you, Mr. Chairman. My name is Robert Kleine. I am currently the director of the office of revenue and tax analysis for the State of Michigan. I was one of the principal authors of the ACIR report. I will try to boil down the testimony and give you the specifics of the model and make it as uncomplicated as possible. I don't want to go into a lot of technical details. I think if we have questions on those I can handle those at that point.

First of all, I would like to say the major purpose of the study was really to identify solutions to the cigarette bootlegging problem that was obviously plaguing many States. The cigarette bootlegging model was really a byproduct, a very useful byproduct I think, but only a byproduct of the study and not the final word on cigarette bootlegging. A number of other criteria were also used to determine the magnitude and the severity of bootlegging problems in the States.

The purpose of the model we felt was to measure how extensive the problem was and the relative magnitude of the problem. The specific revenue numbers that were produced, I would admit in some cases, were subject to large errors, but overall I have considerable faith in the capacity of the model to represent the situation. I am not that confident about a specific dollar loss figure for each State.

For example, our 1975 estimated loss for the State of Florida due to bootlegging was $35.7 million. That compared with an estimated loss of $6.9 million for Michigan. I think this allows one to say with a great deal of confidence that the bootlegging problem is much more serious, for example, in Florida than Michigan. But I won't claim the specific dollar numbers are completely accurate. There is some range of error there.

ERROR RATE

Senator CHILES. Can you put any kind of estimate on what you think the rate of error would be, plus or minus 10 percent?

Mr. KLEINE. Well, I was going to get into that a little later, Mr. Chairman. I don't know if I can give you a specific number. Maybe I can make it clearer.

The theory of the model we developed is as the tax on cigarettes rises, the untaxed cigarettes going into the State also rises. Other things being equal, if cigarette tax evasion is generally prevalent, most high tax States should have lower than average per capita cigarette sales for which the State tax has been paid, reflecting the substitution of bootleg cigarettes for tax paid cigarettes sold in the State. Low tax States should exhibit higher than average per capita sales since they should be sources for smuggled cigarettes going to high tax States.

This is in fact the case if you look at today. On page 17 of our ACIR report we have a table that shows that. I also updated the data for 1979, and that still holds.

The few exceptions to this can really be explained by other factors. For example, Rhode Island has above average consumption, although the tax rate is 18 cents, which is quite high. I think a plausible explanation is it is a small populated State and it is surrounded by two relatively high populated States, Connecticut and Massachusetts, which have higher cigarette tax rates. So the opportunity for people to cross the border and purchase cigarettes in Rhode Island is quite prevalent. I think that would explain the consumption.

The other extreme is Idaho, for example, with a relatively low tax rate of 9.1 cents, but also a low per capita consumption. This can really be explained by the fact that there is a very heavy Mormon population in the State of Idaho. As you probably know, the Mormon religion discourages smoking. That is one of the reasons why it is one of the lowest in the Nation.

RELATIONSHIP BETWEEN TAX AND CONSUMPTION

The objective of our specific analysis was to test the available data for the existence of a substantial inverse relationship between State and local cigarette tax rates and tax paid per capita cigarette sales. If data on the 50 States suggests such a relationship exists for the Nation as a whole, then this would support the contention that a national problem exists.

In talks with law enforcement officials, trade representatives, and others, we were convinced a bootlegging problem existed but wanted to verify in statistical quantities the extent and magnitude of the problem.

CROSS SECTIONAL ANALYSIS

In the development of the model, we sought to identify the factors that explained the variations in per capita consumption among the States. To do this we performed what we called a cross sectional analysis which is really running data for all of the 50 States for one particular year, in this case 1975, and also used multiple regression analysis techniques which would allow us to explain changes in consumption and changes in other factors.

ALTERNATIVE APPROACHES

I might say here that an alternative approach could be used. One alternative would be a time series analysis for each State, using the historical data for 20 years for each State to try to quantify the bootlegging problem. We didn't do it because we judged this approach too time consuming where all 50 States were involved and not necessary for our purposes. But it could be done for any specific State.

The multiple regression analysis techniques are designed to test the dependence of a given variable upon a number of given factors. We desired to test the dependence of 1975 per capita cigarette sales upon tax and nontax factors. Let me go into the variables.

VARIABLES CONSIDERED

First of all, one of the most important is the State cigarette tax rate. We also used a local cigarette tax rate because in some cases that could create an area where the taxes were higher in one part of the State and encourage bootlegging. Tax differentials with border States would, of course, increase the opportunity for bootlegging. We used a border State factor to identify high tax States with low tax States on their borders, for example, Massachusetts and New Hampshire. We also used variables to isolate the lowest tax States in a region. For example, New Hampshire in the Northeast, and Kentucky and North Carolina in the South, which are very low tax States and could be the source of some smuggling. These last two variables were highly significant, I think, and provided some proof that there was interstate bootlegging.

Other variables we used, which were not directly associated with bootlegging, were the percent of the population above 18 and tourism. Age affects per capita consumption as does tourism particularly in Nevada and Vermont. It does play a role in Florida, too, even though maybe a little less because that State has a large resident population. We also used religion as a variable because the Mormon religion discourages smoking. We used per capita income which studies have shown has some impact on cigarette consumption.

We tested a number of other variables, such as the population on Indian reservations, population density, and the male-female ratio. These proved not to be significant so we didn't use them in the study.

In order to develop our bootlegging estimates, we estimated per capita sales using all of these different variables and then we also estimated hypothetical per capita sales by varying only the factors we considered unrelated to bootlegging, basically assuming that each State had fairly constant tax rates and there was no opportunity for bootlegging, and the only differences in States were explained by differences like income differences, tourism differences, and so forth.

Then we used actual per capita sales and substituted hypothetical sales and came up with capital gains and losses for various States.

One problem with this approach is to take into account what we call a consumption effect, the fact that if you have higher prices for cigarettes, say largely due to higher taxes, that naturally dampens consumption somewhat, just like it would any goods or services. So we had to adjust for that factor. I will explain that in a minute.

Now the results of our analysis accounted for 95 percent of the variations in per capita cigarette sales among the States. All the factors we used we found to be statistically significant. One of the most important results we obtained was the impact of the State tax factor, which was a 3.6 pack decline in per capita sales for every 1-cent increase in the State's tax on cigarettes.

SOURCE OF ERRORS

As far as the confidence in this estimate, we can say with 95 percent confidence, statistically that is, that the loss was between 2.9 packs and 4.4 packs. That is the kind of confidence we can place on that particular estimate.

The sources of error in the estimates that we produced are really three as we see them. One is the consumption effect I talked about; some of the reduction in sales because of high tax rates results from price increases dampening consumption. However, most studies have found that cigarette smoking is a habit which is relatively unresponsive to price changes.

We looked at a number of studies to determine what the so-called price elasticity is, for example, for a 1-percent increase in price, what kind of an impact would there be on consumption. We used a factor of minus 0.34. What this indicated to us is that about 60 percent of the decline in per capita sales due to an increase in the tax rate was due to bootlegging and about 40 percent to the consumption effect.

Now the estimates are quite sensitive to this assumption, particularly for high tax States. For example, in the Florida instance, they range from a revenue loss of about $16 million to $52 million depending on the presumed consumption effect or the price elasticity factor you use. I am not saying this range is necessarily plausible. We think our estimate of $35.7 million is the most plausible number. We just want to indicate that is one source of error in the specific revenue loss numbers.

Senator CHILES. That is the 1975 estimate, right?

Mr. KLEINE. That is the 1975 estimate.

Senator CHILES. Could you update that to 1979?

Mr. KLEINE. We have not done that ourselves, yet. I will comment on that, too, shortly.

Another major source of error was the adjustment we made so that, for the 50 States, the average smuggling gain or loss in per capita sales was zero, so it balanced out. We had to make a fairly arbitrary adjustment to do this. I am not going to go into it. It is a fairly complicated technique. That again could add some error to the estimate. That is explained on page 9 of the testimony in a little more detail.

The final source of error stems from regression analysis which, at best, describes average impact and therefore, when estimates of loss are made for particular States, their potential for error is enlarged. In other words, the coefficients we got from our model were average for all of the 50 States, then you apply it to each individual State, so when you use those averages again that creates some potential for error in an individual State.

Now because of the various assumptions that we used there is no way to measure the potential range of error. In fact it could be these errors from different sources offset. Of course it also could be they are operating in the same direction. However, we do believe the model provides reasonable estimates of the relative magnitude of the cigarette bootlegging in the various States.

You should also understand the model cannot pinpoint the various types of problems: organized crime, military stores, or Indian reservations. We can only say the loss due to different types of cigarette bootlegging is such-and-such an amount. We can't say how much is due to organized crime or to other specific factors.

A final point here is that a statistical model is really dynamic and it is not static. It must be maintained and updated to remain useful. I believe the model was relatively dependable in 1975 but I couldn't place the same kind of confidence in the model today without retesting and updating it. However, I can say that the ATF, Alcohol, Tobacco and Firearms rerun of our model indicates the model is holding up fairly well. The results were as might be expected considering the developments from 1975 to the present.

Personally I would like the model updated and retested to have complete confidence in its capability of producing accurate estimates.

SPECIAL CHARACTERISTICS OF FLORIDA

One thing I wanted to say about Florida is that their ACIR has produced a report that I think indicated some criticism of our estimates. Their criticism was based in part on the fact that they found Florida's per capita sales to be only slightly below the U.S. average. They said that if Florida has a bootlegging problem, it should be well below that.

I have pointed out that there are a number of factors that explain cigarette consumption other than bootlegging. For example, in Florida, tourism and the age composition are very important factors that should push Florida's per capita consumption well above the average, heavy tourism and a large part of the population over 18. I don't think that criteria is valid for saying there is no bootlegging problem.

They also said that the decline in consumption in low tax States since 1975 contradicts our report. I don't think that is true. The downturn in consumption in the low tax States, and I am talking about Kentucky, North Carolina, and New Hampshire, began in 1976. As I have mentioned in my testimony, it appears that cigarette bootlegging is becoming less of a problem. The per capita consumption of the source States has declined, which I think is a good sign. So I think these criticisms of the model are not really justified.

Now to talk just a minute about the Florida situation. We had some difficulty specifically estimating per capita sales in Florida. Our 1975 estimates underestimated consumption by about 8 percent. I looked at the 1979 numbers and they look like they are underestimated by about 12 percent.

Part of the problem is that Florida has a very high tax rate—of 24 cents, including sales tax—heavy tourism; extensive sales on Indian reservations and military bases; heavy population concentrations far away from the border of other States where normally there might be some cigarettes going across the border. These kinds of factors make it a little more difficult to estimate sales in Florida than in some other States. And I think that what we would have to do would be to put a little more effort on Florida in particular to concentrate on that particular State and try to develop some other factors we have not yet discovered in order to provide more accurate estimates for Florida.

One other important consideration with Florida is the concern that its bootlegging loss has increased since 1975. That is true in dollar terms, but if you look at the results in number of packs per capita, the actual bootlegging loss dropped from 21.3 packs per capita in 1975 to 20.9 packs in 1979. Although the dollar loss increased, mainly because of the higher tax rate, and our model wouldn't say that because really in real terms the tax rate in Florida, adjusted for inflation, has declined, we would have expected a decline in the per capita loss in Florida, and that is what the model showed. So I think the model doesn't necessarily show the increased bootlegging in Florida. I think it might show there is a slight decline in the bootlegging problem if you look at per capita sales, which is more relevant.

Senator CHILES. How do you explain the fact all the other States have an absolute increase except Florida?

Mr. KLEINE. I think the reason is Florida raised their tax rate much more than most other States. That acted to increase the dollar loss much more than in other States.

One of the things that has happened is that a lot of States have, as we recommended in our report, exercised some restraint in raising their cigarette tax rates, so that their tax rates in most cases were the same as they were in 1975. That did not act to increase the revenue loss.

I really think that it is better to look at the change in per capita consumption rather than the actual dollar figure, if there has been a change in the tax rate.

I think it is difficult to determine from the model specifically whether the bootlegging situation has improved or not in Florida since 1975. I think a model related specifically to Florida might provide more definite answers. I also think field observations might be quite helpful. I think such a model could be developed, and I don't know that I want to volunteer to do such a thing, but I would be willing to help if ACIR wanted to do that.

SPECIAL ANALYSIS NEEDED FOR FLORIDA

Senator CHILES. I think it very much would be warranted and you ought to probably do the same thing for Massachusetts. When you find these two particular States—with an absolute different number from what you find in all of the other States, and we now think that we passed a Federal act that is supposed to do something about it, there is some kind of anomaly there that I think we ought to try to get an answer for. I would appreciate very much if you would develop a specific model for Florida and Massachusetts at the same time.

Mr. KLEINE. I can't commit to that myself. Mr. Shannon maybe could.

Mr. SHANNON. Mr. Chairman, as you point out, in view of the fact these two States are apparently moving in a different direction, I believe our staff definitely could put some time in and try to shed more light on both the Florida and Massachusetts situations.

As Mr. Kleine indicated, from some of his latest checks, there is no question about it, our approach doesn't provide us with as high a degree of confidence with respect to Florida as it does for the average State.

EFFECT OF INCREASING FLORIDA TAXES

Senator CHILES. Is it accurate to summarize, Mr. Kleine, your statement of what you are saying now that you think the major reason the model is projecting these growing revenue losses for Florida is the fact that cigarette taxes in Florida have increased and substantially since 1975?

Mr. KLEINE. That is correct, Mr. Chairman.

Senator CHILES. I understand from your statement that the model shows that for every 1 cent increase in a State's cigarette tax, there is a 3.6 pack per capita sales decline.

Mr. KLEINE. That is correct.

CONSUMPTION EFFECT

Senator CHILES. The largest possible error is the lack of firm knowledge as to how much of that sales decline is due from reduced consumption, just because of the higher price, and how much is due to smuggling.

Mr. KLEINE. That is correct. That would be the largest source of error, yes.

Senator CHILES. So right now you are saying you think that what percentage is due to smuggling and what percentage is due to consumption?

Mr. KLEINE. We thought 60 percent was due to the smuggling and 40 percent to the consumption effect. That is the assumption we used.

On the last page of the testimony I think you will see a table that shows the sensitivity parameters indicating how the numbers could vary depending on what assumption you use as to that ratio.

POPULATION CHARACTERISTICS

Senator CHILES. You indicated the model adjusts for the portion of the population over 18 years of age, and so based on that, and the fact that Florida has a high over 18 age population, a mobile tourism group that is coming in, you see no reason why Florida should have a below average consumption rate. If anything it should be an above average consumption rate.

Mr. KLEINE. That is correct, Mr. Chairman. That is what our model would say. I think intuitively that makes sense, too.

GENERAL COMMENTS

I just want to make one other brief statement before I close out. I just want to indicate that I think all of the evidence that we have been able to look at and the ATF has gathered has indicated that cigarette bootlegging has declined nationwide since 1975. I think that is due partly to Federal legislation, partly to the publicity that has been generated in the last several years. I think higher gas prices have had some impact in terms of making long distance trips less profitable, and also inflation in general which has eroded the profits related to cigarette bootlegging.

ATF shows a $56.6 million reduction on that. I think the loss would be greater if you adjusted for inflation.

Just one other thing on the Michigan experience. We have never had a really serious problem, but we did have somewhat of a minor problem with Kentucky, which isn't very far away, which had a 3-cent tax. We also had a problem with Indiana, which has raised theirs to 10.5 cents now. We have an 11 cent tax in Michigan.

Our law enforcement people several years ago were fairly often capturing quite a few cigarette bootleggers, and now it seldom happens. What they think is happening maybe is that the Federal legislation has discouraged a lot of people from bootlegging. They are waiting to see what is going to develop. Bootleggers may be developing new techniques and becoming sneakier and may come back later.

Our law enforcement people in Michigan do attribute the decline in large part to the Federal legislation. I think one thing we have to do to maintain a favorable trend in this area is that States, if at all possible, should continue to exercise some restraint by not raising their tax rates too much above current levels.

Thank you, Mr. Chairman.

Senator CHILES. Thank you for your testimony.

FLORIDA AS A TARGET

My concern is that with the figures that you are referring to showing, a 56-percent decline elsewhere, that the smugglers have concentrated now on Florida. That is where a high potential is, of course, because of our high tax. So why fool around in a State where there is only a 6- or 8-cent difference. Why not go where the most profit is to be made. It is a natural connection, of course. You are coming straight down from the tobacco producing areas into Florida. You are really coming-down that seaboard. Of course, you could also explain how the smugglers could go both ways, to Massachusetts and Florida, from the cigarette producing areas.

Mr. KLEINE. I think that is true. I think this is a very valid assumption. You would expect a State with a high tax rate, like Florida, which is the highest in the Nation, would be a target. It is quite possible it has been transferred to other States.

Senator CHILES. We want to thank you all for your testimony. We would be delighted if you would work on a more specific model for Massachusetts and Florida. The other questions in regard to your budget we would like answered for the record.

Mr. SHANNON. Thank you, Mr. Chairman. We appreciate this opportunity.

[The information follows:]

QUESTIONS SUBMITTED BY SENATOR CHILES

FISCAL YEAR 1980 PAY RAISE SUPPLEMENTAL

Senator Chiles: The Commission has requested $63,000 for the fiscal year 1980 pay raise supplemental. What portion of the total requirement has been absorbed?

Why couldn't the entire amount be absorbed for fiscal year 1980, including its impact in the 1981 budget?

Mr. Anderson: The gross amount requested to fund the fiscal year 1980 pay raise supplemental was $74,512. ACIR indicated it could absorb $16,130, leaving a final request for $63,484. The Commission absorbed 22% of the total in FY 1980 through reductions in travel, reimbursed parking, and other administrative methods.

Several factors bear on the Commission's inability to absorb more of the FY 1980 civilian pay raise supplemental and its 1981 impact. First, our FY 1980 budget request did not reflect the additional costs for civilian pay raises authorized by Congress under the 1979 act. This is one reason our FY 1980 basic request was less than the amount appropriated for FY 1979. Second, staff turnover in an agency consisting of 37 full-time permanent employees is very low, especially in the positions above GS-9, so our slippage or vacancy savings are very small. The other side of this coin is that ACIR's well seasoned, low turnover staff is a major element of its strength. In fact, there were only seven positions above GS-9, other than intern and senior resident, that turned over in eight years. Third, since over 70% of the Commission's appropriation is used for civilian pay costs, and since 87% of our appropriation goes to pay "fixed" costs, the ability of ACIR to absorb any unforseen expenses, mandated or exceptional, is minimal.

The amount of funds over which ACIR has full discretion has ranged, over the past five years, between $200,000 and $300,000. This year, FY 1980, that amount is projected at $213,000, essentially the same as ACIR had in FY 1976. Inflation has cut deeply into our discretionary funds and with this year's heavier than normal publication load, including the issuance of seven Congressionally-mandated reports, it would be very hard for ACIR to absorb any additional amount. The same problem of limited discretionary funds is built into the FY 1981 request, with 70% again needed for civilian pay costs and 86% needed for total mandated expenses.

It is interesting to note that halfway through FY 1980, ACIR is right on target with regard to incurring obligations, having incurred $809,369 in obligations, or 47% of our total.

FURNITURE

Senator Chiles: How much is included in the 1981 budget proposal for the purchase of furniture? How much is in the 1980 budget request?

Mr. Anderson: No funds are included for the purchase of furniture in either the FY 1980 or FY 1981 budget requests. ACIR has gained a reputation as a scavenger. When other small agencies or unts go out of business, we have them transfer their property and equipment to us. We then surplus to the General Services Administration or other agencies whatever items we cannot use.

The Commission also uses the GSA and GSA contract furniture refinishing and refurbishing facilities when necessary. Since we share warehousing space with GSA at the Ford Plant in Alexandria, VA, we learn when good, usable items come into the warehouse and request what we need.

CONTRIBUTIONS FROM STATE GOVERNMENTS

Senator Chiles: ACIR is intended to serve both the federal government and state and local governments. In view of this responsibility of serving the several levels of governments equally, the Committee expressed the concern last year that only $35,000 or approximately 2% of the total funding requirements were contributed by state governments. The Committee directed the Commission to redress this situation by entering into agreements with other levels of governments to contribute their fair share of the total costs. According to the budget justification, a goal of $100,000 has been established for 1980. How much in actual contributions have been made toward this goal?

What is the goal for 1981?

Since the Commission is intended to serve all levels of government equally, hasn't a more equitable goal, such as 30% to 50% of total funding, been established as the contribution from state and local governments?

Mr. Anderson: The state and local government contributions question should be viewed against the historical background since the establishment of ACIR in 1959. Under the 1959 law Congress enacted to establish ACIR, our Commission was to be funded entirely by Congress, and we were not even authorized to accept contributions. In the beginning it was felt that this was the appropriate means of establishing the agency and proving the federal commitment to the concept. The thought was that once the agency proved its staying power and established its credibility at all three levels of government, contributions should be solicited from the state and local governments. Accordingly, in November, 1966, Congress amended ACIR's law and authorized us to receive funds through contributions

After making solicitations for several years, solicitations were suspended in the early 1970s while an effort was made to raise the contributions through the national organizations representing state and local governments. This effort did not succeed, so ACIR returned to soliciting directly from each of the 50 states. We are in the fourth year of the resumed contributions campaign, and the goal of $100,000 for FY 1980 and FY 1981 was established by both the Congress and OMB four years ago.

All of the states over 5,000,000 population except California and Texas have contributed, and now the California Joint Legislative Budget Committee has recommended a $5,000 contribution in FY 1981, notwithstanding the horrendous financial problems they face if the "Jarvis II" referendum passes.

Our experience in these four years has been reasonably encouraging. Each year we have raised more than in the previous year, and 36 of the states have contributed in one or more years. In FY 1979, 21 states contributed $41,000, and miscellaneous earnings, which include some additional amounts from state and local governments, brought the total to $59,000. In FY 1980, we have already received contributions of $32,000, and pledges from states assure that we will reach a new peak this year.

Experience shows that we are having to build year-by-year and state-by-state. Our major problem is that we may have legions of supporters and users of our products in a state, but whether we receive a contribution usually turns on whether we can impress the Governor, budget officer, and the key appropriations legislators --

all of whom are in high turnover groups. Moreover, ACIR's policy independence must not be sacrificed to its solicitations need, and our Commission's recommendations on such subjects as income tax indexation; state liquor, tobacco, and sales taxation of military sales; and state legislatures' appropriations of federal funds have caused several Governors to turn down our requests.

ACIR faces other problems in raising its contributions total that do not merit detailing here. Manifestly, this climate of tax resistance, new limits on state taxing and spending, and federal aid cuts makes this a difficult time in which to raise money for a Washington-based organization. However, to be stressed is that ACIR fully agrees that all levels should contribute to our support and that we have a clear obligation to raise these contributions. We believe our current approach and schedule of requests are optimum, and we foresee continuous progress in raising the contributions total.

CONTRIBUTIONS FROM OTHER FEDERAL AGENCIES

Senator Chiles: In FY 1980 the Commission is operating a reimbursable program in excess of $760,000. Please describe the nature of this reimbursable program. Why is there no reimbursable program projected for fiscal year 1981?

Mr. Anderson: The essential answer is that the budget format is being changed. Through FY 1979, ACIR had a Consolidated Working Fund account. Through this account, the Commission conducted contract research for other federal agencies on an advancement basis. Due to a decision of the Office of Management and Budget, the Consolidated Working Fund account was merged into the Commission's Salaries and Expenses account beginning with fiscal year 1980, as "reimbursable program." For FY 1980 this consists of ongoing work under contract with the Department of Housing and Urban Development. All of the contracts with HUD end prior to, or coincident with the conclusion of the fiscal year, and, therefore, there is no reimbursable program shown for FY 1981.

OMB has sought to control the amount of contract research conducted through the former Consolidated Working Fund and now the reimbursable program, not in a strict or outright manner, but rather through the approval process, such as limiting staffing and contract authority.

The Commission, however, has maintained an openness to undertaking whatever work it can, and we have done contract work in every recent year. The Commission, in fact, recently reaffirmed that ACIR will seek and accept grants but only to the extent that is consistent with our first obligation to work selected by the Commission or mandated by Congress, and that is within our capacity to manage so as to assure results measuring up to our usual standard of quality. Here it should be noted that ACIR's work program has been dominated for the last four years by eight Congressionally-mandated or requested studies.

IMPLEMENTATION OF COMMISSION RECOMMENDATIONS

Senator Chiles: The entire request for fiscal year 1981 is categorized as intergovernmental research. Doesn't the Commission devote efforts to the implementation of its recommendations? If not, why not?

Mr. Anderson: The Office of Management and Budget has classified the entire budget of the Commission as intergovernmental research because of the interwoven nature of ACIR staff and research. The implementation effort is described in a separate part of the budget justification as "technical assistance" to state and local governments based on intergovernmental research.

Implementation activities -- report dissemination, training and education, and assistance to all forms of legislative bodies, study commissions, etc. -- consume the attention of our seven-person implementation staff plus part of the time of each research staff member and the Executive Director.

RESEARCH PROGRAM FOR FISCAL YEAR 1981

Senator Chiles: The budget justification (page 3) indicates that the Commission has "purposely refrained" from deciding the full array of research activities that it will have underway in fiscal year 1981. Please list and briefly describe those research projects that have been decided on for fiscal year 1981. Also, indicate for each of those projects already committed to the cost of the project.

Mr. Anderson: To clarify the statement in our budget justification, the Commission has "purposely refrained" from selecting research projects to be undertaken by our Government Structure and Functions Section in FY 1981, but it did determine that our Taxation and Finance Section's next major project is "Local Government Finance in the 1980s." This project is fully described in the budget justification and is underway.

Our Government Structure and Functions (public administration) Section is in the process of completing three Congressionally-mandated studies by the end of FY 1980. One of these, the Federal Roles Study, explores which roles or functions are most appropriately the Federal Government's responsibilities and which roles or functions would more appropriately be devolved to state or local governments or left to the private sector. Because of our central position that the federal system is "overloaded" and "overintergovernmentalized" and must be "decongested," it seems very possible that the highest priority for this research section should be follow-up work pertaining to the Federal Role in FY 1981 and possibly later years.

Accordingly, the Commission is scheduled to complete its deliberations concerning recommendations on the Federal Role at its June 19-20 meeting, and it is our plan to then or shortly thereafter place before them some alternatives on how to further define or implement their Federal Role recommendations. The following list of options illustrates the possibilities:

--Development of an overall strategy for decongesting the federal system.

--Selection and examiniation of specific highly intergovernmentalized functions to develop program consolidation proposals and proposals for devolution of certain responsibilities to state and local governments and the private sector.

--Concentration on the 440 small federal aid programs that account for only 10% of the federal aid total money to develop program consolidation and devolution proposals.

--Analysis of selected "national policy objectives" or "cross-cutting regulations" where ten or 25 or more federal agencies have their own implementing regulations, with the objective of achieving greater uniformity and more coordinated implementation. This approach would be required under S.878, the Federal Assistance Reform Act.

--Undertaking research on those many regulatory fields where private enterprise and individuals are simultaneously regulated by the federal, state, and local levels. Regulation probably is as overintergovernmentalized as are government service operations, but ACIR's work to date has concentrated on the federal and state aid systems and not on regulation.

In competition with these projects that would extend our work on the Federal Role will be certain other subjects that the Commission's Special Committee has already identified as prime possibilities:

--Role of private profit and not-for-profit organizations in providing public services financed by federal aid programs.

--Federal mandates requiring action and expenditures by state and local governments.

--The influence of the courts on intergovernmental relations.

Decisions on these work program alternatives will be made by the Commission either at its June or at its September, 1980 meeting. Such decisions will be timely and will allow efficient employment of our personnel because publications clean-up work on the three Congressionally-mandated projects to be completed in FY 1980 will extend into FY 1981.

Because none of the FY 1981 projects, even the local finance project, have been fully designed as yet, neither dollar costs nor man-hour estimates can be provided at this time. ACIR's research staffs, however, typically undertake five or six or more research projects in a year, and the cost of most projects falls within a range between $75,000 and $250,000.

NONDEPARTMENTAL WITNESSES

DIVISION OF ALCOHOLIC BEVERAGES AND TOBACCO—FLORIDA STATE GOVERNMENT

STATEMENT OF CHARLES NUZUM, DIRECTOR

Senator CHILES. Our next witness is Charles Nuzum, director of the division of alcoholic beverages and tobacco of the Florida State government. By having Mr. Nuzum with us today we hope to gain a better understanding of the cigarette bootlegging problem in Florida and the additional steps that could be taken to help solve this particular problem.

Mr. Nuzum, we are delighted to have you with us today. The committee appreciates your traveling to Washington to give us your expert advice on this matter.

I know the reputation of your division in Florida and the high regard you enjoy in the State among your associates. There was a time that we had to be concerned about the beverage department in Florida, but it seems that better days are here for us now, and we are delighted to see that.

We will put your statement in full in the record. We would be pleased to have any summary of your statement.

Mr. NUZUM. Thank you, Mr. Chairman. I appreciate the very kind remarks. I appreciate the opportunity to be here. I am actually honored to have the opportunity to testify before this committee on behalf of our State. I am certainly honored to be here representing Hon. Bob Graham, our Governor.

SEVERITY OF PROBLEM

For a number of reasons the problem of cigarette bootlegging is worse in Florida than in most States. I must state candidly I am not prepared to say it is worse today than it was 5 years ago.

The reason for the fact we have a worse problem than most States is, as you know, our 21 cent tax per pack is the highest in the country.

Our State has a very serious problem of drug trafficking which has financed the best smuggling machinery that money can buy, and this lends itself easily to cigarette trafficking as well. Hoodlums will make money wherever they can.

Because we are some distance from the northeastern States and separated by States with low cigarette taxes, bootlegging in Florida has not received the attention out of State that has been given to other States.

FEDERAL RESPONSE

I don't mean to say that we are ignored. Last fall Director Dickerson came to Florida for meetings with my staff and myself in Miami to discuss the progress of investigations. Also BATF was instrumental in helping Florida obtain approval of a $100,000 grant for a joint Federal-State study of cigarette bootlegging in south Florida.

I think it is fair to say Florida and the Federal Government have recognized their shared responsibilities. But there is more to be done.

In our opinion, a reasonable investment in staff and resources for BATF to expand the scope of investigations could be immensely cost efficient in returning lost revenue to the public treasury.

As you have heard it has been estimated by ACIR that the financial loss to Florida from bootlegging is between $35 million and $50 million a year. Obviously it is hard to pinpoint this because while the legal industry does make reports to us of their sales and purchase of cigarettes, hoodlums do not.

However, the mathematics of improved funding are obvious. If by spending 10 percent of the loss on improved enforcement we could get back maybe half of the loss, the taxpayers would be many, many millions of dollars better off.

We definitely recommend better resources for the Bureau of Alcohol, Tobacco and Firearms, to be concentrated on cigarette smuggling.

One problem is that investigations of this kind are complex, they are time consuming. The Bureau needs to concentrate more on the auditing end of it in my opinion, for example, to trace the paper trail of illegal shipments from the high tax and low tax States and source States and the unpaid taxes.

More and more we believe these investigative trails lead to organized crime. In fact, one of the things that Florida intends to do under the LEAA grant is to make detailed financial investigations of selected cigarette distributors to seek evidence of organized crime involvement in its legal cigarette industry.

SUCCESS OF INVESTIGATIVE ACTIVITIES

The potential for this type of approach was illustrated in recent cases we have handled, including a 1978 investigation which was based on information we received in south Florida from BATF which at that time was not involved in cigarette bootlegging. The Bureau reported that large quantities of untaxed cigarettes were available in south Florida. We began a major investigation, investing the time of a substantial number of our agents—in fact, undercover agents—and we were able to infiltrate a business office of a particular organized activity through information supplied by an informant.

We subsequently videotaped our undercover agents making arrangements to transfer hundreds of cases of untaxed cigarettes to Miami. We knew they were bootlegging.

However, in the 6-month period that this investigation covered, there were hundreds, literally hundreds of criminal transactions of every type conducted and videotaped.

The investigation was a joint effort throughout the Miami area and was concluded with the arrest of 120 persons in 6 States on charges of 32 separate criminal cases, most of which turned out to be involved in illegal drugs. So far there have been 86 convictions in that case, including 6 cigarette related violations and including one count of counterfeiting a cigarette stamp.

Last year our agency, the division of alcoholic beverages and tobacco, made 51 arrests in Florida and seized 212,585 packages of untaxed cigarettes. We also seized 15 vehicles.

ENFORCEMENT PICTURE IMPROVING

We frankly believe the enforcement picture is improving. We have a 14-man cigarette task force funded by the Florida Legislature devoted full time to cigarette tax enforcement as well as the assignment of additional personnel from our 139 enforcement agents as the need arises.

Additionally, Florida pioneered the development of a strong examiner program. We have investigators trained in accounting to audit suspected violators.

Two years ago the Florida Legislature enacted a cigarette vending machine registration law because we were convinced that there was a serious potential for selling untaxed cigarettes through those means. We now have over 30,000 machines registered and we are bringing stragglers into compliance daily with our inspector program.

As far as I personally am concerned, good news in Florida is our cigarette tax revenue, which is substantial, is up 6.5 percent for the first months of this current fiscal year. That is the most recent figure we ave, through February.

This rate of growth, at that time second in the country, is preceded only by Georgia, which has a 9-cent tax rate lower than ours. So I hink that we have evidence that improved enforcement by ourselves nd BATF is being productive.

ADDITIONAL STEPS NEEDED

But there is more to be done. Probably the most obvious step would e to have a campaign of public awareness, because surely to enforce ny law we have to have the consent and support of the people. We eed to call attention to bootlegging again and to the support it gives rganized crime.

We need to do a better job in Florida of publicizing that approxi- ately two-thirds of the $238 million we collected in cigarette taxes last ear was returned by law to cities and counties to provide local tax lief. That is a lot of money for them to spend on whatever type of rvices they desire.

Citizens everywhere need to be encouraged not to participate in a aud on their State that is also harmful to their communities.

As far as the Federal area, I would personally suggest that BATF ncentrate more on informant investigations in North Carolina, Vir- nia, and Kentucky. These are the source States. Information needed authorities in every State is available in those States if it is available ywhere.

It takes patience and willingness to stay with an investigation until it bears fruit. These are not easy investigations. There is not going to be the big, quick kill.

Now what could the State do? Well, we could reduce the State tax to 15 cents, which is comparable to nearby States. However, I doubt if there is very much legislative support for that in Florida because each penny of the State excise tax produced $11.3 million per year. However, reducing that tax would eliminate the incentive for smuggling.

It has been suggested that reducing the tax to a more enforceable level, such as 15 cents, would undercut bootlegging to the extent that tax revenue in total would be the same as it is now. I am not able to see whether this would actually happen.

Another thought might be the States in which cigarettes are taxed could outlaw possession of untaxed cigarettes, regardless of whether they are legally purchased in a lower tax State or a tax free State, such as a military installation or Indian reservation.

Another possibility would be that the Congress could equalize the tax in each State, collect it, and remit it from a collection point of the manufacturer to the States based on sales figures. That is, of course, a very serious step. Low tax States would probably not be appreciative of that.

There is always the problem of the State's right to tax.

Another problem we are faced with is as of our most recent figures, Florida is now losing some $7 million of cigarette tax revenue because of the Federal provisions that excuse the tax on Indian reservations. This is a volume law built up over many, many years. The thought has been expressed perhaps Congress should reimburse the States for this loss. I am not sure the Congress is going to salute that idea, but they certainly could pass a law to apply State excise taxes on Indian sales and to non-Indians.

We have no doubt that bootlegging will continue as long as there is an illicit dollar to be made. Florida can use all of the help it can get, including from the Federal Government.

We do appreciate the help of the BATF with whom we have splendid relations. We encourage the Congress to fund that agency at a level where it can continue to provide that help.

Thank you, Mr. Chairman.

Senator CHILES. Thank you, sir.

SOURCE OF PROBLEM

A number of employees in the Florida State Department of Business Relations we have talked to feel that the bootlegging problem in Florida has been caused primarily by over-the-road bootleggers. The Federal people at the Bureau of ATF feel that the cigarette bootlegging problem in Florida is being caused primarily by diversion or leakage within the legal distribution system.

Where do you think the most significant portion of the problem is occurring?

Mr. NUZUM. I think it is a combination of both of those. Surely there is only one way to get a large quantity of cigarettes to Florida, and that is over the road. But the fact is that despite efforts we have made, including participating with the Public Service Commission in the past couple of years to actually inspect trucks coming into Florida, under the Public Service Commission's powers, all we did was cause a backup of trucks into Florida and Georgia because the word got out over the CB's in the first half hour that "Florida is looking hard. Don't come down." So we have not made any big strikes.

Senator CHILES. What happened when you started inspecting these trucks?

Mr. NUZUM. The trucks were backed up. That is correct. Nobody brought any cigarettes down.

Senator CHILES. Just using their CB's?

Mr. NUZUM. Yes.

Senator CHILES. You mean even ones that were smuggling simply diverted and didn't come into Florida?

Mr. NUZUM. Sure. They just wait it out. We couldn't do this forever.

Senator CHILES. They would wait you out?

Mr. NUZUM. Right. So we have no proof because we have not found any tractor-trailer loads of cigarettes. But that is the only way to get large quantities of cigarettes into the State; either that or airplanes.

Senator CHILES. Before that word would get out, would you pick up any trucks to start with or would you just not find it in the trucks?

Mr. NUZUM. We found only small amounts.

Senator CHILES. Small amounts?

Mr. NUZUM. Yes, sir.

Your other question was about the diversion in the legal industry. I don't think there is any question about that. As a matter of fact, I share ATF's feeling that there probably is diversion in the legal cigarette industry. That is the reason we are in the process of making some audits of some suspected distributors.

GEORGIA STAMPING AGENTS

Senator CHILES. We have been told that a number of cigarette stamping agents in Georgia are authorized by Florida to stamp for Florida. These agents place the Florida stamp on the cigarette packs and ship them to Florida for sale. Then they report to Tallahassee and send a check for the associated tax revenue.

Do you conduct on-site audits of these stamping agents in Georgia?

Mr. NUZUM. Yes, sir, we do. We have stamping agents in all of the southern States that border Florida. Alabama and Mississippi.

Senator CHILES. Why is that necessary?

Mr. NUZUM. Because, for example, as you know, the largest chain of grocery stores in Florida is the Dixie chain. The Dixie chain was headquartered in Montgomery, Ala. So they supply their stores north of there out of Montgomery, including cigarettes.

We in fact conduct the very same audit in all of these border States, including twice yearly physical inventories of their cigarettes and a monthly review of their reports and an exchange of information between Florida and Georgia.

Senator CHILES. You think you have that well controlled so that yo are not worried about that?

Mr. NUZUM. That is right.

INFORMATION FROM PRODUCING STATES

Senator CHILES. You feel that it would be helpful if you had bett information, informant information, coming out of these producin States?

Mr. NUZUM. Without a doubt. We have made efforts ourselves to d this, but the sad fact is within half an hour after somebody from out c town gets into these small towns in North Carolina, everybody know it.

EFFECT ON NEW LAW

Senator CHILES. What difference have you seen since the new law ha passed? How are you able to operate? Is there any difference in the wa you are able to operate? Tell me the changes you have seen or improvements you have seen with regard to the new law.

Mr. NUZUM. Improvements have been two-fold. As far as Nort Carolina goes, the fact that the ATF is now interested in the probler has certainly improved that. There is no question about that.

We have also had improvement because the present Governor c North Carolina, Governor Hunt, about 2 years ago or so, through pe sonal discussions with then Governor Askew, took it upon himself t assign some personnel to North Carolina to be responsive to and helpful to out-of-State enforcement people. We have had excellent cooperation in North Carolina from the State people.

Senator CHILES. So there has been an improvement?

Mr. NUZUM. Yes, sir.

NEED FOR ADDITIONAL LEGISLATION

Senator CHILES. Is there any way, any other Federal legislation yo see or any improvements to the law we could make to make it easier?

Mr. NUZUM. No, sir. I think the Federal law is a well produced sta ute. I think the legislation is there. I really think that what needs to b kept silent is that the cigarette smuggling problem has been building fc 15 years since about 1965. It is not going to be licked overnight merel because the Federal Government passed a law. That is going to hel and it has helped. The truth is organized crime is better organized an better funded than we are.

ORGANIZED CRIME

Senator CHILES. Are you convinced, you sound like you are, that w are talking about a problem in which we are dealing with organize crime as opposed to somebody that gets a camper and decides they ar going to make a run or they are coming through North Carolina s they might as well pick up 30 cartons of cigarettes?

Mr. NUZUM. That is my personal opinion, Senator. I am really nc concerned about somebody who works in Georgia and lives in Floric or has some relatives and friends and goes back and forth and brings couple cartons at a time. That really is peanuts.

What I am concerned about is this is a way of funding organized hoodlums, and any time they come with relative impunity, without much danger of being caught, they make big bucks this way.

Senator CHILES. What you found in a major case that you broke in Fort Lauderdale, and you used the informants and videotaping, you found they were dealing in smuggling of cigarettes, but they were also dealing across the gamut in other organized crime.

Mr. NUZUM. Yes.

Senator CHILES. Drugs was a part of that. There were other illegal activities in addition even to drugs and cigarettes.

Mr. NUZUM. The thing that astounded our people and certainly astounded me was in these dozens of criminal activities that took place, these people, they had so much money they carried it around in paper sacks, or suitcases, or whatever. They wouldn't say good morning, how is the wife, how are the children, what do you think about the ballgame. They spent all of their time talking about organized crime, anything they could do to make a dollar, whether it was drugs, razor blades, cigarettes, anything that they could do to make a criminal dollar.

Senator CHILES. But they were very much involved in the cigarette smuggling?

Mr. NUZUM. Yes, sir.

Senator CHILES. They were in that in a big way. So that was a source of money for the organization.

Mr. NUZUM. Yes, sir.

Senator CHILES. We thank you very much for your testimony this morning.

Mr. NUZUM. Thank you again, Mr. Chairman.

DEPARTMENT OF THE TREASURY

Bureau of Alcohol, Tobacco and Firearms

STATEMENT OF G. R. DICKERSON, DIRECTOR

ACCOMPANIED BY:

- **RICHARD J. DAVIS, ASSISTANT SECRETARY, ENFORCEMENT AND OPERATIONS**
- **ARTHUR D. KALLEN, DIRECTOR, OFFICE OF BUDGET AND PROGRAM ANALYSIS**
- **STEPHEN E. HIGGINS, DEPUTY DIRECTOR, BUREAU OF ALCOHOL, TOBACCO AND FIREARMS**
- **JAMES S. DUNN, CHIEF, FINANCIAL MANAGEMENT DIVISION**
- **MILES KEATHLEY, ASSISTANT DIRECTOR, CRIMINAL ENFORCEMENT**

BUDGET REQUEST

Senator CHILES. The committee will now receive testimony from the Bureau of Alcohol, Tobacco and Firearms regarding the fiscal year 1981 budget request. $144,844,000 is requested for fiscal year 1981. $5,219,000 is requested for fiscal year 1980. That is the pay increase supplemental.

The committee is pleased to have Hon. Richard Davis, Assistant Secretary for Enforcement and Operations, and Mr. G. R. Dickerson, the Director of the Bureau of Alcohol, Tobacco and Firearms, with us today to present testimony on this request.

PREPARED STATEMENTS

Mr. Davis and Mr. Dickerson, we will insert your full statements in the record at this point.

[The statements follow:]

Statement of G. R. Dickerson

It is a privilege to appear before you in support of the FY 1981 budget request for the Bureau of Alcohol, Tobacco and Firearms.

Accompanying me are my associates Mr. Higgins, Deputy Director and Mr. Dunn, Chief, Financial Management Division. Mr. Dunn has not appeared before this Committee, therefore, I am submitting his biographical sketch at the end of my statement. I would also like to introduce Mr. William Drake, Assistant Director, Regulatory Enforcement, and Mr. Miles Keathley, Assistant Director, Criminal Enforcement.

The budget request for FY 1981 as amended by the President's revisions of March, 1980 is $144,844,000 and 3,737 average positions. This represents an increase of $1,142,000 and a decrease of 41 average positions over the authorized level for FY 1980. We are also requesting $5,219,000 for the FY 1980 pay increase supplemental.

The FY 1981 request includes funds to begin a project to bring our law enforcement communications system up to a reasonable performance level, and also funds to lease 3 additional aircraft in support of our enforcement programs. I believe this is a modest request for an agency responsible for the collection of over $8 billion in revenue, vital consumer protection functions, and the protection of the public safety.

ORGANIZATIONAL CHANGES

There have been a number of important organizational changes designed to improve the effectiveness of the Bureau and to give proper emphasis to some important functions. The Criminal Enforcement organization previously provided for direct reporting from each district office to the Assistant Director, Criminal Enforcement. There were two basic deficiencies in the arrangement: with 30 districts, the span of control was obviously to large and, there was no top level management present in the field.

Last July, the Bureau established four Regional Offices of Investigation in the cities of New York, Chicago, San Francisco and Atlanta. Each office is headed by a Regional Director of Investigation who reports directly to the Assistant Director, Criminal Enforcement and supervises the operations of seven to eight district offices. This alignment extends the policy influence of the Office of Criminal Enforcement to the field level; enables a greater degree of coordination of our interrelated program with other bureau managers and other agencies; provides managerial oversight to ensure the best utilization of resources, and also serves as an excellent means for managerial/executive development.

INTERNAL AFFAIRS

The former Office of Inspection has been reorganized into the Office of Internal Affairs to assist in identifying and preventing waste, fraud and corruption. This new structure was designed to provide a more effective response to allegations and allow for greater emphasis on a proactive rather than a reactive approach to safeguarding the Bureau's integrity. Particular emphasis is placed on those areas where the potential exists for bribery, collusion and conflict of interest.

The Internal Affairs Investigations Division has been decentralized, with over half of the staff now located in the field. This arrangement facilitates familiarization with local problems and conditions, reduces travel, and establishes a local presence.

The Operations Review Division inspects and evaluates all offices and programs to ensure compliance with Bureau orders, policies and directives.

The Analysis Support Staff has responsibility in the areas of reports analysis, personnel security backgrounds, including EEO complaints, and the classified document security program.

Internal audits are used to determine if waste, fraud, or abuse has occurred in the Bureau as well as whether intended program results have been achieved.

CONGRESSIONAL AFFAIRS

The Office of Congressional Affairs was also established. It is charged with furnishing Members of Congress information regarding the Bureau's programs and activities and ensures that any item of interest to the Congress receives immediate action and timely response.

PLANNING AND EVALUATION

I have also established an Office of Planning and Evaluation to provide a centralized approach to developing Bureau-wide policy, long-range planning and program assessment. This office will ensure that program planning is comprehensive, well-defined, and that all programs are being carried out to ensure maximum utilization of the Bureau's resources.

INDUSTRY REGULATIONS

We are attempting to carry out our regulatory functions in an enlightened and sensible manner. Where possible, we are deregulating and cutting red tape. We are emphasizing post audit reviews, modern business practices, and computer modeling techniques in nearly all phases of activity involving the industry.

ALL-IN-BOND

One of the highlights of the past year was the initial implementation of the all-in-bond system for distilled spirits. This system grew from the Multi-lateral Trade Negotiations and is embodied in the Distilled Spirits Tax Revision Act of 1979. Over the next several years, we expect to fully implement the new system at all distilleries and eliminate joint custody that has been in place since just after the Civil War.

This means an entirely new approach to revenue protection, which will require new regulations, new procedures, and a large retraining effort. Interim regulations were published on January 1, 1980 concurrent with the effective date of the new system. The new regulations are only two-thirds the size of the old regulations. At the same time, we have simplified industry requirements and reduced the number of forms. The Inspector personnel previously working in the joint custody environment must be given extensive training in audit techniques to enable them to be effective in the new system. We will work with the Office of Personnel Management to develop a training program to meet this need.

ALCOHOL FUEL PRODUCTION

The Bureau is very much aware of the importance of alcohol fuel to the economy of the United States. We have done a great deal to simplify licensing requirements and will continue to encourage production as much as possible.

For the first three months of 1980, we have received applications for 47 commercial distilled spirits plants (DSP), and 1,478 experimental DSP's, wishing to produce alcohol for fuel purposes. During all of 1979, we received a total of 51 applications for commercial DSP's, and 4,243 applications for experimental DSP's. By contrast, we issued only 18 permits for this purpose in 1978. Although the law was not written to accommodate gasohol production, we have relaxed the regulation process to assist both commercial and cooperative ventures in gasohol production. For example, we reduced bond to $100 for small producers. We contributed to the development of the windfall profits legislation which was signed April 2, 1980 and will be effective July 1, 1980. This legislation simplifies gasohol application and regulation and is another example of our attempt to take a reasonable, sensible approach to regulation.

CONSUMER PROTECTION

Consistent with the philosophy of enlightened and sensible regulation, it is our policy to thoroughly examine all issues and alternatives prior to imposing potentially costly regulations. One example of this is the Fetal Alcohol Syndrome. It had been suggested that warning labels be placed on the bottles of alcohol beverages, indicating the potential hazards of drinking during pregnancy. Rather than imposing regulations, an innovative approach was decided upon. We decided that a voluntary industry-government education program would be more effective. With industry cooperation, we are distributing an illustrated booklet using the Rex Morgan, M.D. illustrated series. Also, magazine advertisments and public service television spot announcements will be made in lieu of warning labels.

Another example is our toll-free telephone service in each regional office giving the public direct access to Bureau personnel for answers to any questions they may have.

FURTHER DEREGULATION

I want to emphasize that the Bureau does not believe that Federal regulation of certain sensitive industries can be abandoned; however, regulations can be simplified. We feel that emphasis can be shifted from direct control of operations to a post-audit approach, and that the use of Government-mandated forms and reports can often be replaced by a reliance on the records and controls any efficient business must develop to stay in existence.

The Bureau is moving ahead, with caution, to extend deregulation to a variety of industries. We recently completed an extensive revision of the wine regulations; we are working to simplify recordkeeping and reporting requirements in the brewing industry, and in the industries that use alcohol for industrial purposes. Even more importantly, the Bureau is now examining options to greatly simplify bonding procedures for industrial alcohol permittees. We are committed to deregulation, but not to abandonment of our regulatory responsibilities.

CRIMINAL ENFORCEMENT

I would like now to take a moment to discuss our philosophy in Criminal Enforcement. Our objective in Criminal Enforcement is to have an impact on crime through the statutes we enforce. So, through our statutes, we are cooperating with other Federal and particularly State and local law enforcement agencies as most of our laws require. The objective of this cooperative mode of operation is to have the maximum impact on crime. Our statutes are particularly suited to that, e.g., the firearms statutes and the fact that guns and explosives are frequently misused by criminals.

An example of this mode of operation is the excellent level of cooperation between ATF and the Drug Enforcement Administration (DEA) in "management" and "street" levels. Joint investigations are common where mutual violations are found. Several of these joint investigations have involved major narcotics traffickers and organized crime figures. I would like to cite some examples of these cases.

In April, 1978, ATF and DEA initiated a joint investigation of a prominent Florida organized crime figure for firearms and narcotics activities. In November, 1978 the principal suspect and five associates were arrested and ATF seized 5 handguns, 2 machineguns and 51 silencers. On May 25, 1979, the principal suspect was sentenced to 26 years in prison on 21 counts of Federal firearms and narcotics violations. His associates received commensurate sentences.

In June, 1978, ATF initiated an investigation of the Hells Angles Motorcycle Gang on violations of Federal firearms and explosives laws. ATF and DEA formed a "Hell's Angles Task Force" under the direction of the United States Attorney, which consolidated intelligence on their illegal activities. This investigation culminated with the indictment of 32 members for violating Racketeer Influenced Corrupt Organizations (RICO) statutes. ATF perfected 24 firearms and explosives cases as a result of this joint effort.

In a more recent case during March of this year, ATF executed a Federal search warrant on an individual who is cited by DEA as a Class I drug dealer, convicted felon, and has been arrested on 37 occasions, with charges ranging from homicide to narcotics to gambling. Eighteen firearms, six cases of PCP (the main ingredient used in the manufacture of "speed"), and a large quantity of hard drugs were seized.

The drugs were turned over to DEA for use as evidence, and the individual has been charged by ATF for possessing firearms with a felony conviction. This case is still pending.

Another area we are concentrating on is taking a systems approach to crime analysis. First, in cigarette smuggling where we have done a complete analysis of the industry distribution system, and second, in firearms where we have documented the legal supply and criminal demand system.

In all areas we are developing a complete understanding of the legal industries so that we can concentrate our efforts on diversions and variances from the legal or legitimate systems.

After gaining this understanding, we have developed comprehensive strategies to deal with variances from the legitimate system.

CIGARETTE SMUGGLING

Last year, Congress approved a supplemental appropriation for ATF to combat the interstate smuggling of cigarettes. We believe we have made real progress in assisting the States in this area. Evidence of this is that there has been approximately a $60 million gain in revenue since ATF assumed responsibility. That represents $60 million more revenue for States and $60 million less for the criminal element. We do not claim full credit for this $60 million revenue increase. It is the combined results of: ATF criminal enforcement, State and local public awareness campaigns, and the deterrent effect of the new law. As a result of the extensive knowledge we have gained from the cigarette industry, its distribution system, and the intellignece we have developed, we expect even greater results next year.

Smuggling Strategy

The comprehensive strategy we have developed for dealing with this form of illegal activity includes the following elements: 1) traditional law enforcement investigations of organized smuggling operations through undercover penetration, informant development, surveillance, etc; 2) close coordination, training and institution building at the State and local level, and information referral with State enforcement agencies; 3) development of a comprehensive intelligence base to provide trafficking pattern information for ATF and State enforcement officials; 4) laboratory analysis and expertise in identification of counterfeit State tax indicia, document examination, and ink analysis; 5) public awareness programs; and 6) audit of industry and support of State audits.

FIREARMS PROGRAM

Few contemporary issues generate such emotion, controversy, and polarization as firearms. Any organization at the Federal, State, or local level charged with the enforcement or the administration of firearms laws and regulations must acknowledge these diverse views and carry out its responsibilities. We must recognize both the legitimate sporting and self-protection purposes of firearms and the need to protect citizens from crime and violence. It is, however, in the criminal misuse of firearms where perhaps one finds the common ground of concern for those on all sides of the firearms issue.

As I mentioned, we are developing a systems approach to criminal enforcement. In order to achieve the long-range objective of assisting State and local law enforcement agencies to reduce crime and violence, ATF has developed a strategy designed to place Bureau resources in those areas where maximum impact can be obtained. This strategy is based on our analysis of the firearms supply and demand system in the United States which tracks the movement of guns from the legitimate supply system, into criminal hands, and their actual use in crime.

Firearms Strategy

Based upon the analysis of the firearms supply system discussed above and on the program objective outlined earlier, ATF has developed the following strategy for its firearms program, designed to maximize the impact on firearms crime with minimal disruption on firearms commerce and legitimate use:

- identification and apprehension of major criminal suppliers in firearms
- concentration of ATF activity and support to State and local efforts on elements of the migration sector to prevent the flow of firearms to criminal hands
- assistance in apprehension of major criminals identified by other Federal, State, and local law enforcement agencies who may also be in violation of firearms laws
- cooperation with the U.S. Customs Service and Department of State to prevent the illicit export of firearms
- cooperation with the firearms industry and representatives of other organizations in efforts to develop public awareness and firearms security programs to promote the safeguarding of firearms
- improvement of the institutional capabilities of local law enforcement to combat firearms crime

- development of a comprehensive firearms data base and intelligence system on gun crimes and crime guns without requiring new reports

This strategy focuses on criminals and crime guns. It protects the legitimate uses of guns while protecting the citizen's right to be free from violence and crime.

MAC 10

Let me explain to you one of the problems we have now. In 1979, increasing numbers of converted Military Armament Corporation (MAC 10) machineguns were recovered by ATF and State and local agencies. This machinegun is capable of firing 9mm or .45 caliber shells at a rate of 1090 to 1145 rounds per minute. This weapon is in kit form, which includes the lower receiver cut into pieces with a torch, and all the component parts needed to assemble the firearm. A person with only basic welding and machine shop skills can take the MAC 10 kit and produce a refinished, fully automatic machinegun within approximately two hours or less.

These weapons had been sold in the Atlanta area as deactivated weapons. The recovered weapons used newly manufactured or rewelded receivers combined with existing parts. The weapons were prevalent in the Miami area where they were used in gang-style warfare between rival narcotics smuggling groups. As of January 22, 1980, approximately 500 such weapons have been recovered throughout South Florida. There were approximately 60 drug-related murders in the Miami area. Nine were directly related to the use of this particular weapon, which points out that criminals are arming themselves with more professional weapons. We have taken action to classify this kit as a machinegun to get it out of circulation.

Firearms Tracing

The ATF National Firearms Tracing Center offers one of the most valuable and unique investigative tools available to State, local, and Federal law enforcement agencies. In FY 1979, the Tracing Center traced 58,311 firearms of which 44,592 were for other law enforcement agencies. Of the total firearms traces, 63 percent were traced to their point of first retail sale.

In a limited non-scientific survey of succesful firearm traces for State and local law enforcement agencies, for the period June 1 through December 31, 1979, 3,705 or 60 percent were considered of value. Those which were of assistance in solving a crime numbered 1,972. These crimes included 227 ATF violations; 200 murders, 117 assaults; 536 robberies/burglaries; and 89 narcotics violations. In 978 instances, traces assisted in the recovery of stolen property; 1,020 resulted in arrests or expected arrests, and 899 resulted in indictments being sought. While this was not a definitive study and the data was not statistically selected, I believe that it is an indication that tracing is among the most valuable tools available to law enforcement.

In FY 1979, ATF compiled data for a firearms trace study involving 15,000 crime guns recovered in 18 major cities. When completed, the study will identify crime guns by type, cost, offense, and source. This information will be used by ATF and other law enforcement agencies to devise their enforcement strategies.

EXPLOSIVES PROGRAM

The misuse of explosive materials, whether accidental or criminal, represents a serious threat to the general public. Correspondingly, the Bureau has established the detection and nvestigation of such misuse as the agency's highest priority.

ATF has primary enforcement responsibility for the majority of Federal statutes relating to criminal violations involving explosives. However, with regard to certain violations, the Federal Bureau of Investigation and Postal authorities, respectively, have primary jurisdiction. During FY 1979, ATF investigated 3,313 explosives incidents of which 1,046 involved the actual use of bombs and incendiary devices. Investigation of these incidents resulted in recommendations to both Federal and State prosecutors for the prosecution of 108 suspects. As of December 30, 1979, 44 of these defendants had been convicted.

In September, 1979 the Bureau hosted an Explosives Control Conference attended by Federal, State and local organizations, as well as industry, labor unions and representatives of the Canadian Government. Several significant problems were identified along with proposed solutions. It now remains a requirement for a cooperative effort to implement solutions to these problems.

Explosives Thefts and Losses

ATF has made an effort to stem the serious problem of explosives thefts and losses throughout the country by acting as the central clearinghouse for all information regarding thefts, losses, and recoveries of explosives materials through its reporting and retrieval system know as Stolen Explosives and Recoveries (SEAR). Employed nationwide, its primary objective is assisting other Federal, State, and local law enforcement officials in deterring, detecting, and recovering lost or stolen explosives. To facilitate mandatory reporting of all thefts or losses of explosives materials, ATF provides a 24-hour, toll-free telephone service.

EXPLOSIVES TAGGING

To reduce the hazard to persons and property arising from misuse of explosive materials, ATF has taken the initiative to develop a method to tag explosives. Explosives tagging has the potential to identify and trace explosives used in criminal bombings and to detect explosives before detonation.

ATF tagging research is aimed at the development of taggants that satisfy four stringent criteria:

- UTILITY: The taggants must assist law enforcement and reduce property damage and the number of deaths and injuries caused by bombings.
- SAFETY: The taggants cannot compromise the safety of the commercial explosives products.
- PRODUCT PERFORMANCE: The taggants cannot reduce the effective performance of the commercial explosives products.
- COST: The annual cost of the tagging program must be kept reasonable.

ATF will not compromise these principles in the develop-ent of a meaningful explosive tagging program.

Identification Taggants

The major utility of the identification taggants to law forcement is to provide investigators with lead information r building cases. Bombing cases are extremely difficult vestigations, because the impact of the explosion destroys ch of the physical evidence. The taggants will not solve e crime --- they will enhance the investigators' ability solve the crime by providing them with information about e type of explosive used and the last legal owners of the ticular explosive.

Detection Taggants

Detection taggants will improve capabilities to prevent bombings by emitting a unique vapor that can be machine-sensed if an explosive is brought into a secure area. This technology has not yet been developed to the same degree as the identification tagging technology. However, preliminary research results are encouraging.

Taggant Case

Identification taggants were accepted as admissible evidence by a Federal district court in Baltimore, Maryland (4th Judicial Circuit) in November 1979. In this particular case, a bomb exploded in a truck occupied by two people; the driver was killed and the passenger was injured. ATF submitted evidence from the scene to the Headquarter Laboratory for examination. Two days later, the laboratory had isolated taggants. The taggants were decoded and the information was transmitted to our explosive tracing center.

The trace disclosed that the explosive used was Dupont Tovex 220 Water Gel. Two hundred thirty-eight of these tagged cases had been produced and distributed. ATF agents, using distribution records, traced the purchase to a person already under suspicion. This information permitted the investigators to develop additional evidence. Further investigation led to arrest and indictment of the suspect. The judge, after hearing extensive testimony as to admissibility of the taggant information, accepted it as evidence. On December 18, 1979, the defendant was convicted on three counts: destroying a vehicle used in commerce; destroying a vehicle and the driver; and destroying a vehicle and injuring a passenger. On April 2, 1980 the defendant was sentenced to thrity years in prison.

I have just received a letter from the United States

Attorney for this case in which he described taggants as essential to the conviction of the defendant, both as evidence and as leads to the discovery of further evidence.

ARSON

As we described to the Committee last year, ATF has taken a lead in supporting State and local efforts to combat arson. ATF's role is strictly that - a support role to State and local fire and law enforcement officials.

Our effectiveness in arson investigations and arson training has been recognized by State and local officials, FEMA, LEAA, and the Administration.

ATF investigative jurisdiction in arson is derived from Title XI of the Organized Crime Control Act of 1970 and Title II of the Gun Control Act of 1968. ATF conducts investigations in those arson incidents involving destructive devices such as molotov cocktails as defined under the Gun Control Act or incendiary devices as defined in the Organized Crime Control Act. Legal and scientific research has established that an unconfined chemical compound, such as gasoline, is considered an explosive if, when combined with an oxidizing agent, (air) it could cause an explosion when ignited.

ATF has confined itself jurisdictionally to arsons involving commercial gain through insurance fraud or arson-for-hire schemes as these activities cross State and local urisdictional boundaries. Ninety percent of the ATF arson nvestigations involve commercial property offenses.

Limitations on ATF Role

To ensure that ATF focuses its resources on only the most ignificant arsons and arson offenders, selective criteria ave been developed. Illustrative of the criteria, the rson must fall within ATF jurisdiction; involve or have an effect on interstate or foreign commerce; be beyond the capability, geographical, or jurisdictional limits of a State or local agency; involve a significant property loss or the loss of life or injuries to others; and the suspects or associates must be members of organized crime, white-collar criminals, members of an arson ring, or violent criminals.

ILLICIT LIQUOR

Our efforts to reduce the production of illicit liquor have been extremely successful. Occasionally, however, we have a resurgence of activity necessitating our involvement. Such a situation recently occurred in Franklin County, Virginia. ATF and Virginia law enforcement personnel, in an early morning raid, destroyed 103 stills; 70 violators will face criminal charges. The production capacity of these stills would defraud the Federal and State governments of $8.5 million annually.

RADIO COMMUNICATIONS

In order to support the programs previously described, we need an effective radio communications system.

In FY 1979, the Bureau contracted for an evaluation of its radio communications. The study identified a number of serious deficiencies. The evaluation pointed out the need to improve repeater operations for proper coverage and the capability to handle digital voice privacy transmission; to institute a command center concept; and to exploit the entire range of communications capability by interfacing radio and wireline communications as well as other enforcement communications systems.

In FY 1980, and FY 1981, the Bureau will concentrate its efforts on instituting short range improvements within existing funding, and developing a long-range plan to encompass all of our communications requirements. It is anticipated that realization of communications system needs will require 3 to 5 years implementation.

EQUAL EMPLOYMENT OPPORTUNITY

One of our most important programs is equal employment opportunity. The program has shown considerable gains over the last several years. For example, currently:

- Women represent 33 percent of the Bureau's employees, and other minorities almost 12 percent. This is a significant increase from 1975 when women represented only 24 percent of the work force and other minorities 8 percent.
- In the Regulatory Inspector/Specialist job series, 220 of a work force of 915 are women. Blacks and other minorities hold 78 of these positions.
- In the Special Agent job series, 119 of 1,578 agents are women and minorities. Of special interest, women now number 40 special agents; an increase of 38 since 1975.

During the past year, we have made some significant breakthroughs in the program. For example, a Hispanic was made Special Agent in Charge, GS-15 of the Houston District Office, the first minority to hold such a position; a Black male was made Regional Inspector, GS-15, also a first. A Black male special agent was promoted to Operations Officer, GS-14 in the Western Region and a Black female was selected as GS 510-13 Internal Auditor in Headquarters.

Much of our achievement resulted from our community outreach activities developed to help familiarize the public with the Bureau, its mission, and occupational needs. To attract Hispanics we are continuing our innovative bilingual hiring program which permits hiring authority because OPM registers are insufficient. In addition, we are implementing bilingual-bicultural certification nationwide to make Hispanics available nationwide.

Under the outreach concept, Bureau representatives visited more than 60 of the 108 historically Black colleges and universities. Some 195 applications were received. The Bureau is currently in a very limited hiring posture due to reductions in the firearms program in FY 1980. Notwithstanding, I expect to emphasize EEO through promotional opportunities, the CADE, and cooperative eduction programs.

In addition, every supervisor has been made aware of his/her responsibilities regarding EEO and also the fact that their performances will be evaluated in this area on how well they meet these responsibilities.

Mr. Chairman, this completes my opening statement.

We will be happy to respond to any questions the Committee may have.

STATEMENT OF RICHARD J. DAVIS

It is a pleasure for me to appear before you in support of the FY 1981 budget request for the Bureau of Alcohol, Tobacco and Firearms.

With me today is Mr. G. R. Dickerson, Director of the Bureau, and his staff, and Mr. Arthur Kallen, who is Director of the Office of Budget and Program Analysis for the Department of the Treasury.

The budget request as amended by the President's revisions of March 1980 is for $144,844,000 and 3,737 average positions. While there is an increase of $1,142,000 over the authorized level in FY 1980, after considering mandatory increases, the net result is a decrease in program funding primarily in the area of joint custody. The fiscal year 1980 supplemental request for pay is $5,219,000.

This past year was one which brought many changes and, I believe, significant progress to the Bureau. As you will remember it was almost exactly a year ago that Mr. Dickerson took over as Director and I think he has effectively led the Bureau through difficult but necessary steps including re-examination and reordering of priorities, re-organizations and attempts to communicate better with the regulated industry members and general public.

One of the most important steps taken in the last year is the development of a more aggressive internal affairs program designed to ensure the highest level of integrity and quality of performance possible. In keeping with the Administration's and Congress' intention of eliminating fraud, waste, and abuse from the Federal Government, the Bureau has put into place a decentralized staff of auditors and inspectors who are responsible for using methods of audit and investigation to target potential weak points of internal controls. It is essential that a regulatory agency such as ATF, whose mission includes protecting billions of dollars of revenue, have a strong capability to self-police its own activities and enhancing ATF's ability in this regard has been, and remains, a high priority of both the Bureau and the Department.

Another area which has seen significant developments during the past year is the manner in which the alcohol revenue is protected. One of the most important events was implementation of the Distilled Spirits Tax Revision Act of 1979. This act resulted from the Multilateral Trade Negotiations and moves the Bureau from a system of joint custody of distilled spirits to an all-in-bond system. An important part of this effort is the establishment of the post audit system to ensure that sufficient revenue is collected. No longer will it rely on on-site inspectors as the primary method to make sure there is no diversion of revenue; instead ATF will use improved audit techniques. This represents a major step in simplifying the regulation of the industry while maintaining the ability to assure that the appropriate tax is being paid.

The Bureau met all schedules for implementing the new legislation by issuing temporary regulation concurrently with the statutory effective date of January 1, and briefed industry members on the new requirements and procedures. There has been no perceptible disturbance to industry in making the transition. Over the next few years, we will be modifying the regulations when necessary and working to ensure that the all-in-bond system is fully operational throughout the industry. To do this in a way that assures that the revenue is protected will require that joint custody be phased out over several years as alternative controls are put in place.

In keeping with the President's policies and Congressional desires expressed in the 1978 Energy Tax Act, Treasury has made every effort to expedite and encourage the production of alcohol for use as a fuel, usually as gasohol. Part of our concerted effort has included proposing legislation (now included as part of the Windfall Profit Act) which authorizes ATF to reduce existing statutory requirements for alcohol fuel producers, particularly for the small and medium size producers. Last year, as an interim measure, we used existing provisions for experimental distilleries to allow over 2,967 individuals to establish alcohol fuel facilities with a minimum of burdens. We waived all regulatory requirements possible and even reduced the bond to $100 for small producers. Presently, Treasury is developing a program to implement the administrative action plan instituting the proposed simplified procedures for alcohol fuel producers. This program is intended to simplify application procedures, and auditing and reporting requirements, limit bonding obligations, and make denaturing requirements more reasonable. With the passage of Windfall Profit Act, temporary regulations will be implemented in May. In the future ATF will continue to take the action necessary to expedite the production of alcohol fuels and simplifying the requirement on alcohol fuel producers.

Two other regulatory alcohol issues have continued to receive attention from ATF, Congress and the public. The first concerns the issue of whether a warning label should be added to alcoholic beverage containers. As you know ATF and industry have been working together on an educational program about the Fetal Alcohol Syndrome. In addition, Congress has asked that my office and the Assistant Secretary for Health at HEW report in June on the health problems associated with alcohol, the different ways that have been used to communicate these problems to the general public, and whether a warning label should now be required. We are working with HEW, with the aid of industry members and the public, to prepare a comprehensive report on these matters, including an evaluation of the Fetal Alcohol public awareness campaign co-sponsored by industry and ATF.

The other alcohol labeling issue before Treasury is ingredient labeling. Along with the comments received, an independent regulatory analysis which compares the costs and benefits of a range of regulatory options for ingredient labeling has just been completed and is being reviewed at Treasury together with results from a public opinion poll. The poll attempted to measure whether the public wants ingredient labeling and is willing to pay for it. Because of your interest in this area we will, of course, discuss this with you before any action is taken.

In the criminal enforcement area, I want to discuss two areas - arson and firearms. As we discussed last year the investigative responsibility for arson lies primarily with the States. At the same time the problem is growing at an alarming rate, creating enormous economic costs as well as increasing numbers of deaths and injuries. Thus, there is an important role for the Federal Government in dealing with this problem and ATF, as the agency with primary responsibility in this area, has sought to do so. The Bureau has established criteria, however, to restrict its involvement to major cases where the Federal interest is paramount to a successful investigation.

Finally, in the firearms area, ATF has concentrated its efforts on strengthening its ability to combat illegal firearms trafficking, specifically in stemming the flow and availability of firearms to criminal elements. The Bureau has undertaken a comprehensive review of its strategies and policies to find the best ways to bring available ATF enforcement and regulatory resources to the problem of hindering the flow of firearms to the criminal element. At the same time, ATF has comprehensively reviewed its policies to see whether any unnecessary regulations or policies could be eliminated or changed. For example, changes have been made in the bureau's approach to gun shows and a notice has been published seeking advice on whether the term "engaged in business" could be more clearly defined by regulation. These actions by ATF represent it and its Director's determination to try to enforce the firearms laws, always a controversial area, in a fair and unbiased manner.

Mr. Dickerson has a more detailed statement. After he completes his statement we will be happy to answer any questions you may have.

CIGARETTE BOOTLEGGING

Senator CHILES. Before we hear the highlights of your statements, I would like to continue with our discussion of the cigarette bootlegging problem. I wonder if we could begin by having each of you give the committee your views of the problem and what additional steps would be needed to correct the problem, with special attention to the problem States of Florida and Massachusetts, where we seem to have two States that we don't see a decline in regard to this problem.

OPENING REMARKS OF RICHARD J. DAVIS

Mr. DAVIS. Thank you very much, Mr. Chairman.

The Treasury Department over the last few years has been very interested in trying to do something about this problem. We were active within the executive branch in working with you and other Members of Congress to secure the passage of the Cigarette Bootlegging Act to try and deal with what we perceived then, and perceive now, to be a problem that involved both organized crime as well as losses of revenue.

Mr. Dickerson will describe in more detail the program that the Bureau, in the relatively short time it has had the opportunity to be enforcing this law, has put into place.

I think that this is a particularly unique issue. At the time this legislation was being considered, as you may recall, there were two proposals as to how to deal with it. One was the cigarette bootlegging statute and the other was the uniform national tax.

Cigarette bootlegging is a unique kind of crime because if the tax was uniform nationally there would be no cigarette bootlegging and the crime would be wiped out. There is a legislative solution.

On the other hand, the administration recognized then and we recognize now there are severe difficulties in having Congress impose the national tax policies of particular localities on the country as a whole. Therefore, we supported the cigarette bootlegging statute then and we think that the continued effort in strengthening our enforcement under that statute will provide continuing results.

Director Dickerson has prepared a more detailed presentation on their program. I would like him to give it at this time.

Senator CHILES. Mr. Dickerson?

OPENING REMARKS OF G. R. DICKERSON

Mr. DICKERSON. Thank you, Mr. Chairman.

Mr. Chairman, we have been involved with the cigarette smuggling law that was passed a little over a year ago. I have prepared an outline of our cigarette smuggling program which I would like to submit for the record.

Senator CHILES. All right, sir. That will be accepted and entered into the record, without objection.

[The information follows:]

CIGARETTE SMUGGLING PROGRAM

BACKGROUND

Illicit traffic in cigarettes to avoid the payment of State taxes is a relatively recent form of criminal activity. This illegal diversion of cigarettes represents a significant loss of revenue to the States. At the same time it provides a source of revenue to organized crime. In 1975, 34 States reported losses of cigarette tax revenue. The Advisory Commission on Intergovernmental Relations (ACIR) estimated net losses at $337.1 million.

Cigarette smuggling, cigarette bootlegging, or buttlegging as it is variously described, stems from the widely diverse State tax rates. These rates vary from a low of 2 cents per pack in North Carolina, 2 1/2 cents in Virginia, 3 cents in Kentucky to a high of 21 cents per pack in Florida, Connecticut, and Massachusetts, and 23 cents per pack in New York City which imposes an 8 cent per pack tax over the 15 cent New York State tax. The movement of non-State taxpaid cigarettes is most prevalent along the East Coast where there is the largest disparity in tax per pack rates. It is this variation in State tax rates which provides the economic incentive for cigarette smuggling.

While recent analysis indicates a decline in losses and a lessening of contraband cigarette movement, the problem remains. Casual smuggling by out-of-state buyers in low tax States is a tradition. In 1978, approximately 6.5 million cartons were sold in North Carolina along route I-95 to out-of-state purchasers. There is a direct correlation between the tourist season and cigarette sales in low tax States such as North Carolina. These purchases are generally well under 100 cartons per transaction and are likely to continue as long as the carton prices vary significantly. While control of casual smuggling and the collection of State taxes is basically a function of State officials, Congress recognized the inability of State and local agencies to cope with large scale interstate diversion of cigarettes.

Public discussion of the cigarette smuggling problem has traditionally focused on State revenue losses and has failed to address the associated social costs of cigarette smuggling. High tax States lose needed tax revenues which support vital public services. Moreover, the legitimate cigarette industry is adversely impacted by organized smuggling activities. A 1977 study estimated that as many as one half of all vending machine company employees in New York City had lost their jobs because their companies could not compete with rivals dealing in smuggled cigarettes.

The same study estimated that one third of New York City's licensed cigarette wholesalers had gone out of business because of cigarette smuggling and that honest wholesalers were confronted with a choice of going bankrupt or joining organized smuggling conspiracies.

This paper describes ATF support to State and local jurisdictions which focuses on the large scale interstate movement of cigarettes rather than on casual smuggling.

ATF AUTHORITY

As a result of increasingly large revenue losses incurred by States with high cigarette tax rates, the U.S. Congress enacted Public Law 95-575 on October 25, 1978. The Secretary of the Treasury delegated responsibility for the enforcement of this law to ATF on December 5, 1978.

The law prohibits the transportation, receipt, shipment, possession, distribution or purchase of more than 60,000 cigarettes bearing tax indicia of a State other than the State in which they are found. Tobacco manufacturers, tobacco exporters, common carriers transporting cigarettes under bill of lading, and State licensed tobacco industry members are exempt under this statute. Violation of the statute is punishable by imprisonment for a term not to exceed five years and/or a fine of up to $100,000. Conveyances used to transport contraband cigarettes are subject to seizure.

The law also authorizes the Secretary of the Treasury to issue regulations requiring that persons engaged in transactions involving more than 60,000 cigarettes maintain disposition records to show the name, address, destination, vehicle license number, drivers license number, and signature of the purchaser as well as a statement of the purpose of the purchase and the identity of the principal recipient if the purchaser is acting as an agent. Falsification of the required disposition records is punishable by imprisonment not to exceed three years and/or a fine not to exceed $5,000.

The law does not allow for open inspection of records. Consent or a judicial order are needed to examine the required disposition records and such inspections are limited only to those records specified under the law and its implementing regulations.

Congress also explicitly stated its intent that primary responsibility for cigarette tax enforcement lay at the State level with the Federal effort to be concentrated in those investigations which were beyond the jurisdictional and resource abilities of State agencies. This intent was clearly stated in Section 2345(b) of the law which states as follows:

> "Nothing in this chapter shall be construed to inhibit or otherwise affect any coordinated law enforcement effort by a number of States, through interstate compact or otherwise to provide for the administration of State cigarette tax laws, to provide for the confiscation of cigarettes and other property seized in violation of such laws and to establish cooperative programs for the administration of such laws."

The figure of 60,000 cigarettes was arrived at after Conference Committee deliberations to reconcile differing versions of the law. The House bill had set the proscribed level at 30,000. The Conference Committee agreed on the 60,000 figure in order to concentrate the Federal enforcement effort at a level well above that of the "casual" or occasional smuggler or traveler purchasing cigarettes in low tax States for personal consumption. This intention was further supplemented by including cigarette smuggling within the umbrella of the Racketeer Influenced Corrupt Organizations (RICO) statute.

PROGRAM DEVELOPMENT

Concurrent with the passage of Public Law 95-575 by Congress, ATF initiated planning for the enforcement and administration of the new law. In 1979 the major ATF emphasis was in the following areas:

- developing an understanding of the cigarette industry and distribution system
- creating public and industry awareness of the new law and ATF's intention for vigorous enforcement
- establishing close relationships with State agencies responsible for enforcement and collection of cigarette tax revenues through organizations such as the National Tobacco Tax Association
- training ATF personnel in preparation for enforcement
- working with LEAA to develop a training capability for State and local enforcement personnel

- developing the regulations necessary for the administration and effective enforcement of the new law
- developing an analytical capability to recognize counterfeit State tax stamps
- developing hypotheses on the means of diversion of cigarettes from legal channels to the illicit market
- developing measures for program effectiveness
- determining the extent of over the road smuggling
- developing a data base on cigarette smuggling and smugglers
- developing our long-range plan, objective, and strategy.

ATF developed the program outlined above with the long-term goal of assisting the States in their efforts to curtail organized cigarette smuggling thus increasing State tax revenues and depriving organized crime of this source of revenue. At the same time, ATF hoped to capitalize on the force of the new law by making the Federal presence felt. Liaison with State and local enforcement personnel, a seminar with the National Tobacco Tax Association, and press releases on enforcement action in cigarette cases were all part of an effort to increase State tax revenues as quickly as possible while longer-range, more comprehensive law enforcement plans and a greater understanding of the industry and distribution system were being developed.

This interim strategy combined with the deterrent effect of the new law appears to have had some impact. By 1979, using this same methodology developed by the ACIR for computing State tax losses, the net revenue losses had dropped to $280.5 million, a gain by the States of $56.6 million. Exhibit 1 provides a detailed listing of cigarette tax gains and losses by State.

PROGRAM OBJECTIVE

The objective of the ATF Cigarette Enforcement Program is to measurably reduce the interstate trafficking in cigarettes by organized smuggling groups and to assist State enforcement and revenue agencies in their efforts to combat the illicit traffic in cigarettes and the collection of appropriate State tax revenues.

CIGARETTE SMUGGLING STRATEGY

In order to achieve the objective of the cigarette smuggling program, ATF developed the following overall strategy:

- concentrate traditional law enforcement investigations on organized cigarette smuggling operations through undercover penetration, informant development, surveillance and other techniques
- implement a joint ATF-Florida State Beverage Department Task Force
- increase expertise in the identification of counterfeit State tax indicia and expand services provided by the ATF laboratories to include expert testimony, "questioned document" analysis, and ink analysis
- train 250 State enforcement officers through an LEAA-funded program
- publish recordkeeping regulations and assist the industry in their implementation
- develop and implement a program for voluntary industry compliance with regulations through publications in trade journals, industry circulars, and limited compliance inspections consented to by distributors
- assist the States in development of a public awareness program aimed at deterring the casual smuggler and others engaged in marginal smuggling operations
- use the survey of the cigarette distribution system to develop an investigative/audit program directed toward the identification and investigation of major diversion sources
- assist State enforcement efforts in developing and expanding upon existing State audit capabilities by
  - aiding States in securing LEAA or similar funding for audit training
  - encouraging the use of Schedule C reporting
- implement and use automated intelligence data bases on contraband cigarette trafficking and traffickers.

ACCOMPLISHMENTS

The most significant ATF accomplishment in cigarette smuggling in FY 1979 was the development of an accurate understanding of the dynamics of the legal and illegal cigarette distribution systems. ATF investigation and analysis of available intelligence data established that "over-the-road" smuggling of cigarettes from low tax States to high tax States was not the dominant factor in cigarette smuggling as previously believed. Investigation in low tax States confirmed that casual and loosely organized smuggling activity occurs but at a level below the Federal jurisdictional limit, an observation which is further supported by the sharp decline in "over-the-road" seizures and arrests by State agencies since 1976.

Having discounted over-the-road smuggling as a major source of supply of contraband cigarettes, ATF initiated a study of the legitimate industry distribution system. Figure 1 depicts the distribution system of a typical industry member. From an analysis of the distribution system, ATF identified weaknesses and possible sources of diversion around which we have and will continue to develop our investigative strategy.

The study identified a number of potential sources of diversion; however, it now appears that the greatest potential source is at the stamping agent level due to:

- the extremely large volume of cigarettes processed and the availability of stamping equipment
- the relative freedom from State oversight caused by
    - shortage of state auditors
    - lack of uniform reporting of interstate shipments.

To partially rectify these deficiencies, ATF and the National Tobacco Tax Association (NTTA), have initiated a program to encourage all States to use

CIGARETTE DISTRIBUTION SYSTEM

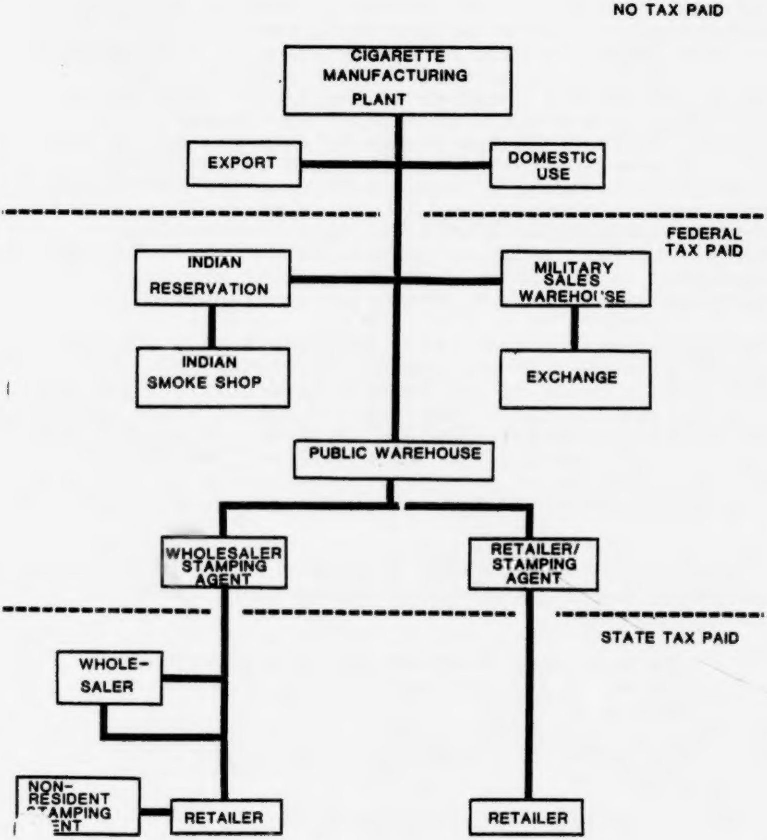

NO TAX PAID
CIGARETTE MANUFACTURING PLANT
EXPORT
DOMESTIC USE
FEDERAL TAX PAID
INDIAN RESERVATION
MILITARY SALES WAREHOUSE
INDIAN SMOKE SHOP
EXCHANGE
PUBLIC WAREHOUSE
WHOLESALER STAMPING AGENT
RETAILER/ STAMPING AGENT
STATE TAX PAID
WHOLE-SALER
NON-RESIDENT STAMPING AGENT
RETAILER
RETAILER

Figure 1

the Schedule C reporting procedures. Schedule C reports are used to verify interstate shipments of cigarettes by interstate stamping agents but are not currently or uniformly used by all States.

Working closely with State officials, ATF assumed the role as a coordination point between State agencies for the interchange of intelligence and for basic enforcement operations. In FY 1979, ATF initiated 233 investigations involving 389 suspects. Five persons were arrested by ATF agents and 24 arrests were made by State officers assisted by ATF. Agents seized 25,535 cartons of cigarettes of which 17,023 were retained by State officials. ATF agents and State officers seized 16 vehicles. Three suspects were indicted on Federal charges while two were charged in State courts. All five indicted suspects were convicted.

In FY 1979, 242 ATF agents received cigarette smuggling training at the Federal Law Enforcement Training Center at Glynco, Georgia. To assist State agencies in developing their own enforcement capabilities, ATF conducted three organized crime/cigarette smuggling schools for 80 law enforcement and NTTA officials. An LEAA grant was also approved to provide similar training to 250 State officers in 18 cities beginning in early 1980.

In FY 1979, ATF laboratories conducted 34 cigarette examinations involving suspected counterfeit State tax indicia. Through close liaison with the tax indicia industry and State officials, ATF has become the national contact point for the identification of counterfeit tax indicia.

ATF intelligence developed and periodically issued a Tobacco Intelligence Bulletin advising ATF and State officials of significant investigations, industry developments, and general intelligence such as smuggling patterns and concealment techniques. ATF is implementing the Tobacco Intelligence Analysis System (TOBIAS). This system will collate information from ATF investigations and analyze smuggling patterns to assist ATF and State enforcement agencies in combatting cigarette trafficking. TOBIAS is scheduled to become operational in March 1980.

ATF joined the Eastern Seaboard Interstate Cigarette Tax Enforcement Group (ESICTG), an organization made up of States with significant cigarette smuggling problems who coordinate their efforts and intelligence to combat smuggling activities. Information from ESICTG and its member States on previously arrested smugglers was gathered, evaluated, and entered into the Treasury Enforcement Communications System (TECS) to provide a sorely needed tactical intelligence base for field investigators. Descriptions and serial numbers of stolen cigarette stamping machines were also entered into TECS.

The Office of Regulatory Enforcement has developed and published the regulations to implement the recordkeeping provisions of the law. These regulations include only the precise information specified in the law.

Following are examples of ATF cigarette smuggling investigations conducted during FY 1979.

Burlington, Vermont

On November 7, 1979, a task force of 45 ATF, State, and local investigators executed four search warrants in the Burlington, Vermont area in connection with an illegal cigarette distribution operation. Through informant information, surveillance, and undercover purchases, the eight month investigation established that the suspects, operating a State licensed wholesale cigarette stamping operation, had used a stolen stamping machine to counterfeit Vermont tax indicia on cigarettes which were then sold through unsuspecting retail channels. The machine had been stolen from an interstate shipment in 1966. It is the first such recovery by ATF. There have been 51 stamping machines lost or stolen nationally since 1951. The ATF laboratory had identified cigarettes having been stamped with the stolen machine prior to its recovery.

ATF also seized 6,139 cartons of cigarettes. Vermont authorities recovered 3,500 additional cartons from retail outlets supplied by the suspects. Further investigation established the tax loss to the State of Vermont at $1,782,000 during the life of the operation.

No charges have yet been filed in this case due to the extensive follow-up investigation required. A Federal Grand Jury is still hearing evidence on the matter.

Other Cases

In March 1979, ATF agents in North Carolina developed information that a North Carolina cigarette diverter would be transporting a large load of cigarettes to an unknown location. The suspect was observed loading cigarettes into his vehicle which he drove to a remote location in Virginia where the cigarettes were offloaded onto two vehicles with New York license plates.

The surveillance of the two vehicles continued to New York City. One was stopped in Brooklyn with 1,242 cartons of cigarettes and the other suspect was apprehended in Staten Island with 5,587 cartons of cigarettes. This investigation is pending Federal prosecution.

In April 1979, ATF and the Washington, DC Metropolitan Police Department arrested two suspects and seized 5,430 cartons of cigarettes which had been smuggled into the District of Columbia from Virginia. One of the suspects had a previous arrest for smuggling.

In February 1979, ATF agents in Raleigh, North Carolina developed information that a local resident would be smuggling a large quantity of cigarettes to a northern State. A subsequent investigation by ATF agents in Rhode Island resulted in the arrest of two subjects and the seizure of 3,187 cartons of cigarettes. The potential tax loss to Rhode Island was $5,376.

CONCLUSIONS

In the short time period that ATF has been involved in cigarette smuggling investigations, there has been a measurable increase in cigarette tax revenues in high tax States with a corresponding decrease in revenue in low tax states located along the Atlantic corridor.

During the past year, ATF has completed some significant investigations and has developed a better knowledge of both the legitimate and the illicit cigarette distribution systems. Increased experience has resulted in the development of investigative and technical expertise in the area. This expertise has been passed on to the States to expand their skills through training and coordination of investigative efforts.

The knowledge and expertise gained in the previous 10 months will provide a foundation upon which to build a viable and effective enforcement program. This program will significantly impact directly on organized smuggling operations through the use of traditional enforcement techniques as well as the development and implementation of an investigative/audit approach to sources of diversion within the legal industry.

ATF will continue to assist State officials in their efforts to combat illicit cigarette trafficking through coordination of investigative efforts, intelligence sharing, and joint task forces where appropriate. These efforts will be concentrated in those areas where State revenue loss is greatest.

Exhibit 1

DETAILED REVENUE LOSS BY STATE

State and Rate Per Package	Estimated Per Capita Sales 1975	Estimated Per Capita Sales 1979	Estimated Gain or Loss (-) Dollars in Millions 1975	Estimated Gain or Loss (-) Dollars in Millions 1979
Alabama (12)	114.5	125.2	$ -6.9	$ -4.3
Alaska (8)	146.7	132.7	0.2	.1
Arizona (13)	108.4	119.9	-3.4	-.7
Arkansas (17.75)	109.3	119.7	-6.5	-5.0
California (10)	130.9	127.6	-16.0	-19.9
Colorado (10)	136.0	132.3	-0.3	-.2
Connecticut (21)	116.3	125.3	-15.1	-9.9
Delaware (14)	142.5	140.5	-0.2	-.1
District of Columbia (13)	175.9	143.7	0.2	-1.0
Florida (21)	122.3	119.4	-35.7	-43.0
Georgia (12)	128.4	133.4	-2.8	-2.1
Hawaii (14)	N/A	N/A	N/A	N/A
Idaho (9.1)	126.1	124.3	0.3	.1
Illinois (12)	130.8	132.3	-21.7	-15.7
Indiana (10.5)	157.5	138.8	4.0	-.7
Iowa (13)	130.5	134.5	-4.0	-2.7
Kansas (11)	128.1	130.0	-1.6	-.9
Kentucky (3)	224.3	208.2	13.3	10.9
Louisiana (11)	123.7	131.4	-2.1	-.7
Maine (16)	120.7	131.1	-2.1	-.8
Maryland (10)	143.9	141.8	0.2	-1.3
Massachusetts (21)	130.9	121.9	-12.1	-20.8
Michigan (11)	134.5	136.8	-6.9	-4.4
Minnesota (18)	116.0	125.4	-12.2	-8.4
Mississippi (11)	117.9	123.2	-1.3	-1.4
Missouri (9)	132.8	137.0	-5.0	-2.8
Montana (12)	122.2	124.4	-0.3	-.1
Nebraska (13)	122.8	121.7	-1.7	-1.5
Nevada (10)	208.0	184.0	0.4	.9
New Hampshire (12)	269.1	254.5	11.3	11.6
New Jersey (19)	121.9	128.3	-26.0	-17.1
New Mexico (12)	104.6	117.3	-1.0	-.1
New York (15)	120.4	123.9	-72.3	-53.2
North Carolina (2)	224.7	204.0	16.6	9.2
North Dakota (12)	123.5	124.1	-0.2	-.1
Ohio (15)	127.8	132.4	-16.9	-11.8
Oklahoma (18)	124.0	118.4	-1.2	-3.7
Oregon (9)	144.4	145.9	1.5	2.2
Pennsylvania (18)	123.4	119.1	-35.6	-22.9
Rhode Island (18)	143.8	134.9	-0.3	-1.0

State and Rate Per Package	Estimated Per Capita Sales		Estimated Gain or Loss (-) Dollars in Millions	
	1975	1979	1975	1979
South Carolina (7)	143.0	141.1	$ 1.4	$ .6
South Dakota (14)	123.6	123.8	-0.1	-.1
Tennessee (13)	121.7	125.4	-7.8	-8.1
Texas (18.5)	110.0	120.0	-43.1	-31.0
Utah (10)	78.3	81.2	0.3	-.1
Vermont (12)	159.6	172.3	1.0	1.8
Virginia (2.5)	159.3	154.8	2.5	1.9
Washington (16)	104.4	113.3	-13.2	-9.4
West Virginia (17)	129.3	122.6	-1.9	-4.2
Wisconsin (16)	115.6	125.6	-13.6	-8.9
Wyoming (8)	146.1	143.1	0.2	.3
National average	134.9	138.8		

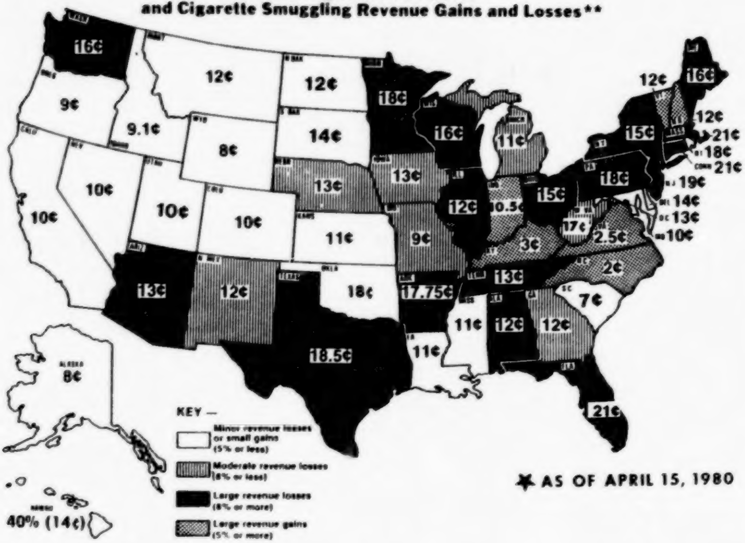
Mr. DICKERSON. I will summarize the progress that has been made during the past year.

This problem, Mr. Chairman, has been outlined by previous speakers. But it comes about as a result primarily of the differences in the tax rates between the various States. I think this chart is a very helpful one in showing what those problem areas are. For example, source States such as North Carolina where the tax is 2 cents, whereas we have high tax States such as Florida with 21 cents; Pennsylvania, 18 cents; New York, 19 cents. This type of disparity in tax rates provides an inducement for the smuggling of cigarettes from one State to another—inducement which we think, and based on the statistics that have been prepared and discussed by the previous speaker, resulted in a one-time tax loss of between $300 and $400 million to the high tax States.

I should point out while smuggling cigarettes has been made a Federal crime, it is primarily a State problem.

[The chart follows:]

State Cigarette Tax Rates*
and Cigarette Smuggling Revenue Gains and Losses**


16¢
12¢
12¢
18¢
12¢
16¢
9¢
9.1¢
8¢
14¢
16¢
11¢
15¢
12¢
21¢
18¢
21¢
13¢
13¢
10¢
10¢
10¢
10¢
12¢
10.5¢
15¢
18¢
19¢
14¢
13¢
10¢
11¢
9¢
17¢
2.5¢
3¢
13¢
2¢
13¢
12¢
18¢
17.75¢
7¢
11¢
12¢
12¢
11¢
18.5¢
21¢
ALASKA
8¢
40% (14¢)
KEY —
Minor revenue losses or small gains (5% or less)
Moderate revenue losses (8% or less)
Large revenue losses (8% or more)
Large revenue gains (5% or more)

★ AS OF APRIL 15, 1980

In our efforts during the past year, most of our emphasis has been on not only directly attacking the actual shipping itself but in providing assistance to the States and trying to help them deal with what is essentially their own problem.

I think we have made substantial progress. We have spent a good deal of our time in learning more about what the problem is and gaining some institutional knowledge of what the problem is.

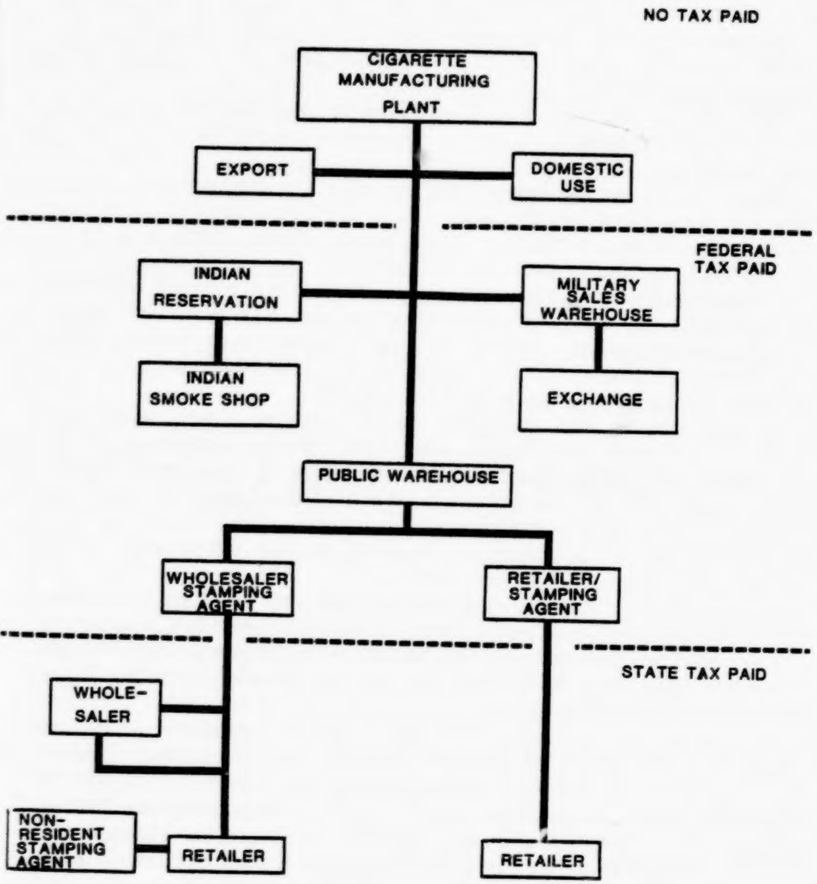
CIGARETTE DISTRIBUTION SYSTEM STUDY

We also have, in cooperation with the States, mounted a number of enforcement efforts which I think themselves have been very successful and will continue to be successful. We have, as I said, continued our efforts to assist the States. One of the principal things we accomplished last year was to begin learning indepth what the cigarette distribution system is. We did this through an in-depth audit of one of the cigarette manufacturing distribution systems, with the cooperation of the manufacturers and a number of the States.

This chart shows in a general way what that distribution system is. It shows the various potentials for leakage from the system for avoidance of taxes.

[The chart follows:]

CIGARETTE DISTRIBUTION SYSTEM


NO TAX PAID
CIGARETTE MANUFACTURING PLANT
EXPORT
DOMESTIC USE
FEDERAL TAX PAID
INDIAN RESERVATION
MILITARY SALES WAREHOUSE
INDIAN SMOKE SHOP
EXCHANGE
PUBLIC WAREHOUSE
WHOLESALER STAMPING AGENT
RETAILER/ STAMPING AGENT
STATE TAX PAID
WHOLE-SALER
NON-RESIDENT STAMPING AGENT
RETAILER
RETAILER

For example, in some States, there are sales to Indian reservati *and in some States sales to military warehouses*—which, incidentall might point out neither of these come within the jurisdiction of Federal Government.

Senator CHILES. Neither come within the jurisdiction of what?

Mr. DICKERSON. Of ATF.

Through this survey or audit, we have been able to identify poter areas for diversion from the legal distribution system. One that mentioned earlier is the stamping agents. We think that is an which requires an in-depth look at.

TASK FORCE EFFORTS

Based on this survey and our enforcement efforts, we also condu a task force effort in the source States for approximately 45 days year, detailing agents from around the country and intensifying efforts to develop informants and information about over-the-road o ations in these States.

From this we feel that while there is some over-the-road smuggl the principal problem is diversion somewhere within the legal di bution system.

Based on that, we are intensifying our efforts in cooperation with States to concentrate on the weak points we have identified. We h developed a strategy working with the States, which I think is goin be extremely helpful in pursuing this problem.

We are continuing to concentrate our criminal enforcement resou on smuggling operations. We are setting up joint ATF-State task for Mr. Nuzum mentioned Florida. We have worked with Florida S officials with LEAA funding of approximately $100,000 to set up a j ATF-State task force to work on this problem.

In source States and tax States we are working closely with S authorities in these task force arrangements. We have concentrated developing laboratory expertise in identification of counterfeit indi and working with the manufacturers. We have developed the capab for finding and identifying counterfeit stamps—again, something we will use in our investigations and will provide information to States to help them in their investigations.

We are assisting States directly through training programs, provi for audit programs, and encouraging the use of Schedule C—whic the report from one State to another State on transshipment of c rettes from one State to another. We are also working with the St on public awareness programs.

We are putting into place the recordkeeping regulations which required by the statute. We are developing a sophisticated intellige base regarding various types of smuggling and the major source diversion within the legal distribution system. This intelligence bas available not only to our own investigators, but also to the States.

Our enforcement effort has been successful. During the last year have seized 55,000 cartons of cigarettes and 25 vehicles.

Senator CHILES. How much?

Mr. DICKERSON. 55,000 cartons of cigarettes and 25 vehicles. There have been 83 arrests of individuals who will be tried either under State jurisdiction or Federal jurisdiction.

Senator CHILES. Is that nationwide?

Mr. DICKERSON. This is nationwide, yes, sir. In one instance, working with State authorities, we identified a stolen stamping machine which had been placed in operation and which had resulted in a tax loss of $1,700,000 to that particular State.

I might point out that we also have several undercover operations involving organized crime figures which will go to a grand jury in the near future. So we think there will be additional significant arrests and seizures regarding cigarette smuggling in the near future.

We have been working with and have had meetings with the individual States, as well as the National Tobacco Tax Association. We have conducted three training courses for approximately 80 State officials. We have funding from LEAA for $99,000 to conduct 18 additional schools for State and local officials. We are working, as I mentioned, on establishing a Florida-ATF joint task force and with Florida officials on a State seminar that will be conducted there in the near future.

We have, as was mentioned in previous testimony, updated the tax loss statistics which were originally prepared by the Adivsory Committee on Intergovernmental Relations. This would indicate that the potential tax loss since the law has been passed, has been reduced by approximately $6 million.

I think that the offer by the Advisory Committee on Intergovernmental Affairs, to conduct special studies in Massachusetts and Florida would be extremely helpful in trying to identify what the problem is in those States.

In summary, we are working with the State very much. We think substantial progress has been made on this problem and we will continue these efforts.

I would be glad to answer any questions on this subject you may have, Mr. Chairman.

THE LEGAL DISTRIBUTION SYSTEM

Senator CHILES. If your conclusion is, and I assume it is, that most of the smuggling is now occurring through leakage in the legal distribution system rather than the tractor-trailers carrying the loads of cigarettes, it would seem that basically the way that you would attack that would be through your auditors, trying to audit that diversion. How many auditors do you have assigned to that task?

Mr. DUNN. Sir, we have 49 special agents and 11 support personnel. Our program we are requesting is about $2.7 million.

Mr. DICKERSON. Mr. Chairman, we do not have any auditors assigned full time to this specific program. We do have approximately 26 auditors in our Internal Affairs Office, and we are currently building regulatory audit capability in our Regulatory Office. By the end of the year, we will have about 40. We use those auditors part time combined

with our enforcement effort in auditing the system. We have
somewhere between four and six auditors assigned full time to date.

I agree with you that audits of this distribution system will be
portant. But I think we will also have to continue our criminal
forcement activities. When I say the problem is in the legal distribu
system, there is over-the-road smuggling also. We have to continue
efforts by informant development, surveillance, and underco
operations in conjunction with the auditing performance.

Senator Chiles. Well, I kind of heard everything you said, but
thing that I basically got out of it is that you don't have any audi
assigned full time to this task and yet that is what you feel is where
principal leakage is occurring.

Mr. Dickerson. We have had approximately four to six audi
assigned essentially full time for the last 6 months to attack
problem.

Senator Chiles. Well, four to six auditors when we are talking ab
the kind of revenue loss we are seeing here is not much. It seems lik
is through the legal system that you find the loss, that would be a
easier to correct than if you had to go out there and catch every tr
that is coming through. It seems like the potential for what the g
would be compared to the cost of auditors would make it worthwhil
add auditors. The gain would be very, very high with the numbe
dollars we are talking about here.

Mr. Dickerson. Mr. Chairman, I can't question your logic. I wo
like to have more resources in the program. But on the other hand,
are trying to develop State capability, since many of these operati
are conducted under State jurisdiction.

For example, in Florida we are conducting an audit with the S
authorities there now and they are providing full-time auditors to w
with us. So one of our efforts will be to develop State audit capabi
as we identify areas we think need tightening up.

Mr. Davis. Mr. Chairman, the second aspect is that, in addition
having auditors, ATF has a program to upgrade its inspectors with
creased audit expertise. In the long range, we plan to look at the spe
agents force because we believe special agents with financial experie
are needed for these kinds of investigations.

ORGANIZED CRIME INVOLVEMENT

Senator Chiles. Well, when I look at the testimony generally that
received and the fact that this is an area in which organized crim
definitely operating, I believe we face a serious matter. The Colun
family, according to the 1972 New York State investigations, are c
ducting a $20 million a year business between New York and Flor
going through North Carolina; the U.S. Advisory Commission
Intergovernmental Relations conservatively estimates that bootlegg
cost the American taxpayer $390 million in 1975, and we have org
ized crime participating in that very strongly. Interstate bootlegging
four New York crime families employing more than 500 enforc
peddlers, and distributors in smuggling an estimated 480 million pa

into the State each year. That is from an Atlanta press story dealing with the smuggling into New York. Has all of that kind of smuggling been stopped by the new law or is it still there? Is this a part of what we are concerned with, not just cigarette smuggling but every other illegal activity? Aren't drugs piggybacked right into the smuggling operation?

Mr. DICKERSON. They certainly are. Our information definitely indicates that there is still substantial organized crime involvement, possibly both in the legal distribution system and through other means of smuggling.

As a matter of fact, as I mentioned, we do have some undercover operations which I can't discuss right now which will show this with some certainty in the very near future.

I am aware of the situation that Mr. Nuzum mentioned in Florida. This also is our findings through our intelligence efforts. Organized crime, people who are involved in criminal activities or narcotics smuggling, are the types who do turn to cigarette smuggling. It is an easy way in which they can gain illicit funds, until the Federal law was passed.

I do think that passage of the Federal law and the involvement of ATF in this operation has had a suppressing effect on the amount of traffic that is going on.

AGENTS CONDUCTING CIGARETTE SMUGGLING CASES

Senator CHILES. We have been told that because of personnel classifications agents who work cigarette bootlegging cases can't easily qualify for the GS-13 ratings. Therefore, your best agents and your senior agents very much don't want to work in bootlegging cases. Is that correct?

Mr. DICKERSON. We have had both our senior and junior agents working on this. We have had a minor internal problem in our classification system, but I have taken action on this and I think it is corrected.

Senator CHILES. I didn't hear that.

Mr. DICKERSON. I have taken action to correct it. I don't think it is a serious problem anymore.

Senator CHILES. I understand you have 52 agents assigned to Florida. I wonder, considering the problems we have in Florida, whether more of the ATF resources shouldn't be transferred to that State and to other States experiencing the kind of particular problems that we are having.

Mr. DICKERSON. Mr. Chairman, during the past year we did transfer some additional agents into the source States to improve our surveillance and informant capability. I also am in the process of increasing our agents in Florida.

However, the few additional ones I have added down there, have been offset by some losses I have had down there. But it is my intention to increase the staffing in Florida; not only because of the cigarette smuggling problem but the significant firearms problem.

Senator CHILES. Is there anyone at ATF who is assigned full time to provide national direction to the ATF cigarette bootlegging problem?

Mr. Dickerson. Yes, sir. I have at least one senior investigative officer assigned full time to the problem. He is supported by another man who is full time.

Senator Chiles. What is his name and what is his title, what rank?

Mr. Dickerson. It is Mr. Ed Hughes, who is a special agent in charge of organized crime.

Senator Chiles. What is his GS rating?

Mr. Dickerson. GS–14.

Senator Chiles. That is his prime responsibility, to give direction to the cigarette bootlegging problem?

Mr. Dickerson. His overall program concerns organized crime. But because of the cigarette smuggling problem, most of his time has been spent substantially on cigarette smuggling.

Senator Chiles. Well, it seems to me in your organization with this role that you have and with the Federal statute that there would be somebody that would be giving overall direction to the program. That that would be his box, that would be his title, or that would be what he is supposed to be doing, coming up with a program on that.

Mr. Dickerson. A special agent in charge of suppression of cigarette smuggling?

Senator Chiles. Well, I am not talking about necessarily a special agent. I am talking about one of our high-priced bureaucrats that sits in the office doing some thinking or doing some planning and being in charge of the program.

Mr. Dickerson. I can assure you that not only Mr. Hughes is involved in this substantially full time. We have an officer in charge of the Investigations Division who spends a good bit of his time on cigarette smuggling. Mr. Keathley, who is Assistant Director for Criminal Enforcement, spends a considerable amount of his time on it. I spend a substantial amount of my time on the cigarette smuggling problem. We do consider it important.

HIGHLIGHTS OF THE BUDGET REQUESTS

Senator Chiles. We will go on now to hear the highlights of your overall statement in support of the 1980 supplemental and the 1981 budget request.

Mr. Davis, you may go first.

HIGHLIGHTS OF RICHARD J. DAVIS' STATEMENT

Mr. Davis. Mr. Chairman, Senator McClure, I appreciate being here today on behalf of the ATF 1980 supplemental and 1981 budget request. I will very briefly summarize my statement.

The ATF budget request this year, given the inflation and pay increases, is a very modest one involving a cut in personnel. At the same time, it envisions building upon continuing changes that have taken place over the last year in such areas as Internal Affairs where a new organization has been created; a very significant change in terms of the total revamping of the method of collection of the tax on outlawed beverages, and conversion to all-in-bond. This process, which is underway, involves not only long-range savings but also involves the need to carefully phase out the old system and phase in the new system so as not to risk $8 billion in revenue which is collected in that area.

It involves progress in the gasohol area where ATF has made substantial efforts under existing statutes to try and simplify the ability of people to deal with the problems of making gasohol. ATF is in the process of implementing new legislation which I know Senator McClure was very interested in. That was part of the Windfall Profits Tax Act. We expect to be on time in processing the implementing regulations required by that statute.

It has also been a year in which we have continued to be involved in important regulatory issues. One issue relates to warning labels on alcoholic beverages. The Bureau has been working on a public awareness program with the alcoholic beverage industry and other groups relating to Fetal Alcohol Syndrome and is preparing with HEW, as required by congressional mandate, a report covering the entire area.

Another is the ingredient labeling issue which has occupied the Bureau's time, and we expect to have a decision within the next week or so which will resolve that issue. In that area, we have completed a detailed regulatory analysis which will be released at the time the final decision is made.

In the criminal enforcement area, we have already discussed substantially the cigarette bootlegging area. In addition, the ATF Director will explain a little more on this.

There have been substantial resources spent in developing and trying to refine its approach to the problem of arson. AFT continues with its efforts in the explosives and firearms area to try and combat illegal firearms and trafficking and doing what it can under its laws to stem the flow and availability of firearms to criminal elements.

That completes the summary of my statement, Mr. Chairman. Mr. Dickerson may have a brief summary.

Senator CHILES. Mr. Dickerson?

FISCAL YEAR 1981 REQUEST

Mr. DICKERSON. Thank you, Mr. Chairman.

First let me introduce my associates with me: Mr. Higgins, Deputy Director of the Bureau; Mr. Dunn, Chief, Financial Management Division; and Mr. Keathley, Assistant Director for Criminal Enforcement.

My request for fiscal year 1981 as amended by the President's revisions of March 1980—reduction of 32 average positions—is $144,844,000 and 3,737 average positions. This is an increase of $1,142,000 but reflects a decrease of 41 average positions over fiscal year 1980.

ORGANIZATIONAL CHANGES

Mr. Davis mentioned that we made a number of important organizational changes designed to improve the Bureau's effectiveness and give proper emphasis to important functions.

Last July we established four regional offices of investigations to provide better managerial oversight of our investigative activities in the

REGULATORY FUNCTIONS

Mr. Chairman, first I would like to speak very briefly about our regulatory function. Where it is possible, we are deregulating, cutting redtape, and shifting much of our emphasis in the regulatory area from onsite inspections to more modern inspections.

The particular regulatory area in which we are shifting our emphasis is joint custody to all-in-bond. We started on January 1 of this year and expect to fully implement a new system within the next several years This will eliminate joint custody and is a new approach to revenue protection which will require new directives.

We simplified our industry requirements and reduced the number of forms. The new regulations are only two-thirds the size of the old regulations.

In the area of gasohol, we have done a great deal to simplify licensing requirements. We will continue to encourage production as much as possible.

We reduced bond to $100 for small producers. We contributed to legislation which simplifies gasohol application and regulation. This summer, we will issue new regulations under the recently enacted windfall profits tax law.

Another item of interest is in the Fetal Alcohol Syndrome. It has been suggested that warning labels be placed on bottles of alcoholic beverages. Instead of warning labels we chose to develop a voluntary Government-industry program which we feel will be more effective. Rather than imposing additional regulations, we are working with industry and attempting to educate and make the public more knowledgeable of the possible damages.

I have included a brochure which has an example of the illustrated Dr. Morgan strip which is aimed at reaching people at the high school age.

CRIMINAL ENFORCEMENT

I would like to discuss just for a minute our philosophy in the criminal enforcement area. Our objective in this area is to have an impact on crime through the statutes we enforce. We feel that one of our major objectives is to cooperate with other Federal, and particularly, State drug enforcement agencies in any way we can, to impact on crime.

I think one example of the excellent cooperation we have is between ATF and the Drug Enforcement Administration. This cooperation is not only at the management level where we have periodic meetings. I have also met at the field level with the staffs to develop cooperating programs where we can concentrate not only on the problem of narcotics, but the related problem of firearms, which is often associated with narcotics.

Mr. Chairman, I guess there are few issues which generate such emotion or controversy as firearms. Any Federal organization charged with the enforcement or administration of firearms laws and regulations must acknowledge these diverse views.

However, in the criminal use of firearms, I think there is a common ground of concern for all. That is the prevention of the criminal misuse of firearms.

We are developing a systems approach to criminal enforcement as it relates to firearms. Our firearm strategy is based on the analysis of the firearms supply and demand in the United States. It tracks the movement of guns from the legitimate supply system into criminal hands and their actual use in crime.

The development of a strategy which focuses on criminals and their guns is a strategy which does not restrict the legitimate use of guns; yet it does help protect the citizens' right to be free from violence and crime.

MAC-10 PROBLEM

Mr. Chairman, one of the more serious problems we have had concerning firearms is the MAC-10 machinegun which is in general use by many criminal elements throughout the country. I have visited Miami and I was particularly concerned because I found that there have been in excess of 60 drug related murders in the Miami area recently. In nine of those murders, the MAC-10 machinegun had been used or was involved.

This machinegun, Mr. Chairman, is sold in kit form at a price of approximately $80. One manufacturer was partially destroying the receiver of the machinegun and a large number of them were sold and did show up in criminal hands. In fact, the murders I mentioned in the Miami area were done with machineguns where the receiver had been cut, rewelded back, and restored to operating condition.

Senator Chiles. That is the MAC-10?

Mr. Dickerson. Yes, sir.

Senator Chiles. It sold in a kit for how much?

Mr. Dickerson. Something like $80 to $100. When restored, it is sold in the illegal market for around $1,500.

Senator Chiles. But the way it was sold, you simply could take it in and have it welded and put back together.

Mr. Dickerson. Yes, sir; and in approximately 2 hours time by a good mechanic. We found a large number not only of the kits that were restored, but also illegal diversion of unregistered machineguns.

We have several activities relating to that. The FBI has seized approximately 50 of these. We have seized in excess of 500.

They distribute them in the illicit market. By reclassifying it as a machinegun and taking them out of circulation, and through our enforcement efforts, we will greatly reduce the availability of this gun for criminal purposes.

Senator Chiles. How many of those are still out in the countryside today or in the marketplace?

Mr. Dickerson. Mr. Chairman, it would have to be a guess, but there are, unfortunately, still a large number of them out. But I think through our actions and two separate seizures—over 500 seized by ATF and seizures by some local authorities also in Florida—we certainly have taken a large number of the illegal weapons out of distribution.

I will try to provide you some sort of estimate for the record as to what is available.

Senator Chiles. We would like to have that.

[The information follows:]

Estimate of Mac-10 Kits in Circulation

Approximately 2,000 kits were manufactured for sale. This estimate was ba
interviews with the manufacturer and his distributors. Of this number, 180 hav
retrieved.

EXPLOSIVES THEFTS

Mr. Dickerson. Mr. Chairman, we are also striving to ster
serious problem of explosives thefts and losses throughout the co
ATF is the central clearinghouse of information regarding thefts, l
and recoveries of explosive material. We provide 24-hour toll fre
phone service to facilitate this effort.

RESEARCH ON EXPLOSIVES TAGGING

We are continuing our research and development efforts to tag
sives. I think we have had pretty favorable results. Taggants hav
potential of identifying and tracing explosives used in cr
bombings, and in detecting explosives before detonation. Ta
cannot solve the problem of this crime, but they will aid investi
by providing them with information about the type of explosive
and the last legal owner.

I should emphasize that our research is continuing to insur
taggants are safe and will be useful in preventing crime. They w
affect the performance of explosives and can be used by industr
cost-effective manner.

We have had during the year an incident in which an individua
was developed through the use of taggants which had been placed
experimental batch of explosives by an explosives manufacturer.
particular case, the bomb exploded in a truck occupied by two p
The driver was killed and the passenger was injured.

Using evidence on the scene with the taggants, they were a
trace it to a person already under suspicion. This information per
the investigators to develop additional evidence which led to the
and indictment of the suspect.

I received a letter from the U.S. attorney for this case statin
taggants were essential to the conviction of the defendant, b
evidence and as leads to the discovery of further evidence.

I would like to submit that letter for the record.

Senator Chiles. That will be entered into the record.

[The information follows:]

Letter From U.S. Attorney

April 1,

Mr. G. R. Dickerson,
Director, Bureau of Alcohol, Tobacco and Firearms, Federal Office Building, Was
D.C.

Dear Mr. Dickerson: This office recently prosecuted James L. McFillin
bombing murder of his nephew, Nathan A. Allen, Sr. He was convicted afte
week jury trial. The investigation and prosecution succeeded largely because of
covery of taggants at the crime scene, which resulted in the prompt tracing
purchase of explosives used in the bomb and enabled the ATF agents conduc
investigation to recover other evidence which might otherwise have disappeared
successfully concealed.

On May 10, 1979, a bomb exploded in the cab of Nathan Allen's pickup causing his death. No explosive material was found at the scene; therefore the explosive used could not be traced. On May 16 taggants were found in vacuum sweepings from the truck. The taggants identified the explosive as Tovex 220, a DuPon watergel explosive. By May 17 ATF agents learned that on March 10, 1979, in Martinsburg, West Virginia, McFillin, who was the uncle and neighbor of the victim had purchased Tovex 220 which contained the same taggants as those found at the crime scene.

The explosives seller remembered that McFillin had placed the Tovex in his automobile, a fact that contributed to the establishment of probable cause for a search of McFillin's car. A search warrant executed on the car on May 22, 1979, resulted in the discovery of wires matching those on the bomb harness. Those wires, plus the taggants themselves, were the critical evidence linking McFillin directly to the bomb.

Thus the taggants were essential to the conviction of the defendant, both as evidence and as leads to the discovery of further evidence. Certainly a program which produces such strong evidence and prompt investigative leads should be encouraged.

Very truly yours,

RUSSELL T. BAKER, Jr.,
U.S. Attorney.

ARSON

Mr. DICKERSON. As we described to the committee last year, ATF has taken a lead in supporting State and local efforts to combat arson. Our effectiveness in arson investigations and arson training has been recognized by State and local officials, FEMA, and the Law Enforcement Assistance Administration.

We have confined ourselves to arsons involving commercial gain through insurance fraud or arson-for-hire. ATF focuses resources on only the most significant arsons and arson offenders, with 90 percent of the ATF arson investigations involving commercial property.

EQUAL EMPLOYMENT OPPORTUNITY

Mr. Chairman, I will end by reporting very briefly on gains we have made in equal employment opportunity. In 1975 women represented only 24 percent of our work force. Currently 33 percent of the Bureau's employees are women. Other minorities have been raised from 8 percent to 12 percent for the total staff. There are currently 220 minorities in inspector/specialist positions. Of special interest, we now have 40 female agents, an increase of 38 since 1975.

We are continuing in this area with community outreach activities and direct improvement to include our representation by Hispanics and other minorities in the ATF work force.

Mr. Chairman, that summarizes my statement. We would be glad to answer any questions.

Senator CHILES. Thank you very much.

Senator McClure has been very patient for a long period of time. We will let him ask questions.

NEW ALCOHOL APPLICATION PROCEDURES

Senator McCLURE. Thank you very much, Mr. Chairman.

I know that this afternoon will be the primary hearing with respect to gun control enforcement activities. I am unable to be there this afternoon.

I have a number of questions I would like to ask, and I will confine them to the issues of gun control and with respect to the alcohol program.

First of all, I think it would be unfair for me not to at the outset thank you for your assistance that you have offered through your congressional affairs office. In a recent contact my staff brought to your attention the case of a Mr. and Mrs. Crockett in Pocatello, Idaho, who had sent in their fee for a black powder permit but never received their permit. After contacting Mr. Lawrence of your office, the permit was sent immediately out of the San Francisco office. The Crocketts received it within a few days.

I might just add one other word of thanks there. You were so doggone good in doing that, that they also got a second one by registered mail almost immediately. [Laughter.] I appreciate that.

On page 6 of your statement, Mr. Dickerson, you discuss your activities in streamlining the application procedure for alcohol fuel permits. First of all, I want to thank you for cooperating with me on my legislation, the amendment that was added to the windfall profits legislation to streamline the procedures. As you point out, that law does go into effect on July 1, 1980. Have you begun preparing these new application regulations to be ready to go into effect coinciding with the effective date?

Mr. HIGGINS. Yes; we began actually preparing regulations in anticipation of the passage of the act. We are preparing them now. We will be ready by that date. In fact, we hope to be ready in advance of that date, July 1.

Senator McCLURE. So there should be no timelag as a result of the preparation of regulations?

Mr. HIGGINS. We would hope there would be no lag. I guess because of the date that they will have to be published without opportunity to comment on them in advance. But, we will be taking comments over an interim period and making changes as we go along.

Senator McCLURE. Can you at the time you publish the regulations also publish notice of change in regulations so you can get the opportunity for comments on changes, coinciding with the promulgation of the regulations themselves, so that——

Mr. HIGGINS. Yes.

Senator McCLURE [continuing]. In effect you put them into effect on July 1 but give opportunity for whatever changes are indicated by public experience or input?

Mr. DICKERSON. Yes, sir. We will publish what we call interim regulations, which means they will go into force but we will certainly accept comments on the regulations.

Mr. DAVIS. Senator McClure, one thing that has assisted in that effort is when we submitted the legislation, we also submitted a detailed outline of our proposed approach to the regulations. Then through the congressional process we received many useful comments that can be factored into the interim regulations. I think the system worked fairly well in expediting the ultimate product.

Senator McCLURE. The legislation that has passed and been signed by the President specifically addressed the new regulation for small producer applications—one of the most troublesome areas for you, I am certain—but also directed ATF to take steps to streamline the applications and minimize the bond for medium and large producers as well.

What steps have been or will be taken to follow this new congressional directive?

Mr. HIGGINS. I guarantee you that we have taken that advice into consideration. We think the bond amounts we are developing for the middle and upper size of producers will be very reasonable. We are making every effort to hold those down. We are also trying to reduce the amount of paperwork that would be involved for those people. Some applications will be from full-scale commercial producers and we will have a fair amount of paperwork.

Senator MCCLURE. But we don't have any problem with the major producers. I think they are prepared to, expect to, and will comply with full-blown procedures that would be required for any large producer.

The medium sized, however, falls somewhere between there, obviously; and the small ones have the simplified procedures. Many of them, even though they may be relatively large producers in terms of distilleries who produce alcohol beverages, would be small producers when considered as alcohol fuel producers. There needs to be some medium enforcement/registration/paperwork procedure for that group of people.

When do you expect that those will be ready to go into effect? You say you expect that they will be. When will they be?

Mr. HIGGINS. I think we could provide you with more specific information as to the effective date of the temporary rule. We want them effective by July 1, 1980 and hope to have them out by the end of May or 1st of June. But we are probably being very optimistic. So I would rather provide you with a copy of our work plan.

[The information follows:]

WORK PLAN NO. 28(a), ALCOHOL FUEL REGULATIONS, REVISION OF 27 CFR PART 19

1. Due to delay in enactment of enabling legislation, target dates for this project have been amended. Work Plan No. 28 was approved March 6, 1980. This regulatory project would revise existing regulations in 27 CFR Part 19 by inserting a new subpart with respect to distilled spirits for fuel use. Enabling legislation is included in H.R. 3919, Crude Oil Windfall Profit Tax Act of 1979, as passed by the Senate. The provisions affecting distilled spirits plants will be effective approximately 60 days from enactment.

2. Currently, there is no provision in law for simplified requirements specifically for alcohol fuel plants. Persons wishing to produce alcohol for fuel use may either (1) obtain permits to do so as experimental distilled spirits plants or (2) qualify under the same provisions of Part 19 which apply to all other plants. Qualification as an experimental distilled spirits plant is of limited duration. The provisions of Part 19, which apply to all non-experimental plants, involve a complicated qualification procedure which is inappropriate for the majority of gasohol producers. These new regulations are needed to provide a simpler scheme of qualification and control, thus facilitating the establishment of alcohol fuel plants.

3. The statutory basis of the regulations is a new section of law, 26 U.S.C. 5181, and related amendments to 26 U.S.C. Chapter 51, which are included in H.R. 3919. The statutory authority for issuing regulations under Title 26 is contained in 26 U.S.C. 7805.

4. For further information contact John V. Jarowski, Specialist, Research and Regulations Branch, 202-566-7626.

5. A regulatory analysis will not be prepared because this regulation is considered nonsignificant. This regulation establishes liberalized requirements with respect to the distilled spirits for fuel use. It does not impose substantive additional requirements or costs on affected parties.

6. The Administration's recent policy statements on encouraging gasohol production impact this project.

7. Chapter 51 provides for regulation of all distilled spirits plants in order to protect Government revenues. The proposed legislation incorporated in H.R. 3919 recognizes this by allowing for liberal-

ized regulation of fuel plants by means of a waiver of specific provisions, rather than by making such plants wholly exempt. The administrative action plan submitted with the proposed legislation and the proposed regulations both attempt to limit regulation of alcohol fuel plants to the minimum acceptable level.

8. This project will result in the issuance of a temporary rule, effective [upon publication in the Federal Register] July 1, 1980. A 120-day comment period will be provided. A final rule will not be issued until after the public comments have been evaluated.

9. Target dates for this project are as follows:

   (a) Temporary rule drafted and reviewed within the Bureau, [February 29, 1980;] May 9, 1980;

   (b) Completion of review within Treasury, [March 21, 1980;] May 23, 1980;

   (c) Proposed date of publication [and effective date of temporary rule, April 1, 1980;] in the Federal Register, June 6, 1980;

   (d) Effective date of temporary rule, July 1, 1980.

   (e) Expiration of comment period, [August 1, 1980;] October 6, 1980;

   (f) Issuance of final rule, provided public comments do not indicate a need for hearings, [December 1, 1980.] February 2, 1981.

URGENCY OF ALCOHOL FUEL

Senator McClure. I would like to express some sense of urgency. I think Congress has repeatedly indicated that they are very concerned about the development of alcohol as a fuel and determined that we get going on that.

Now we have added reasons Congress wanted to do that. One is our dependence on foreign fuels and the economic and political problems it is causing us with respect to our importation of foreign oil. We also have an absolute disaster in the farm economy of this country today.

The other reason why we were interested in alcohol legislation was to expand the markets for agricultural commodities. If it is to be of any use to them this year, it needs to be underway.

Mr. Davis. Senator, the administration shares your concern and interest in this area. Our goal is to have these interim proposals out substantially before the effective date and then to get comments, and subsequently, to make changes as warranted. We share your concerns.

Senator McClure. I think you do. Certainly the administration has indicated all along good support for this program. As a matter of fact, I think it is significant to note that in the conference between the House and the Senate on the windfall profits tax bill, this provision is the only one that survived as a tax credit mechanism or a tax treatment mechanism. So that gives some indication of the feeling on the part of both the Congress and the administration of the importance of the program.

But it can fail in the administration. It can be just as badly hampered by administration as if we hadn't passed the legislation. I think you are conscious of that.

Mr. DAVIS. We are conscious of that and we expect to be reminded by you and others if on any points we have not delivered.

Senator MCCLURE. Well, I look forward to working with you in that area. It is going to require some changes. You recognize that. We recognize that. It also requires kind of a change in the mind-set of a regulatory agency that in this particular area has been a tax collector, a revenue collector you'll have to move from the fear you are going to lose revenues even to the position that says we are going to expedite production, an entirely different kind of middle process.

Mr. DAVIS. Somebody in the Department of Treasury suggested that I could be known as the Godfather of the moonshining business for working on this legislation.

ISSUANCE OF ALCOHOL FUEL APPLICATIONS

Senator MCCLURE. I haven't seen you drive the back roads at night. [Laughter.] Maybe you are good at that, too. It could be.

But I am concerned, too, that on page 6 you have identified the number of applications that you had. You contrast that with 1978 in which only 18 permits were issued. But you don't indicate what progress you are making in the issuance of the applications. You only identified the number you have received, but you haven't indicated what success you have had in handling those applications.

Mr. DICKERSON. Mr. McClure, we have had substantial success in handling them. We did at one time, I will admit, have a backlog problem. I think it is indicative of this year. We had 18 requests, and the next year we were inundated with 4,000.

But we did take steps to delegate it out to the field to deal with these. We simplified the process. We currently have outstanding, as of April 4, only 970 applications. That compares with 2,400 that were pending September 30 of last year.

Of those that are outstanding, I think a large number of those will be people who write in and we write back for additional information. The processing time is very good to date.

Senator MCCLURE. I still receive a number of comments and complaints from constituents saying:

> You can't imagine what a hassle it is to deal with BATF. You can't imagine how difficult it is to get a decision out of them. I have been waiting and waiting and waiting.

Do you think that is getting better and those complaints are going to diminish?

Mr. DICKERSON. I think it is substantially better. I believe with the new legislation it will be an even greater improvement. We not only have tried to improve our process but we have gone out and encouraged the States to try to eliminate and simplify the process they have, which has also been a problem for people attempting to obtain permits.

MAC-10 PROBLEM

Senator McClure. I want to address just one other subject and then I will leave the balance of them for the hearing this afternoon and others can raise the questions.

You mentioned the MAC-10 problem. That is a troublesome one. As I understand what happened in the MAC-10 situation, at least one dealer sought to market deactivated machineguns.

Now, that is legal under the law and under regulations, as I understand it. If it is not operable, it can be owned.

Now there is also the section of the law that says readily rendered operable. You first gave detailed directions to this individual as to how to disable the MAC-10. If they did specific things in cutting the receiver apart, removing at least one-eighth inch of metal at each of the separate pieces you directed it be cut, that then it would be legal for them to sell. Is that not correct?

Mr. Dickerson. Yes, sir. A Mr. W. Daniels wrote to ATF and stated that he had a few which were operable machineguns and he wanted to sell them for certain purposes. I think they were for the purpose of wall plaques and wall ornaments. The individual also wanted to know what steps he would have to take to deactivate them.

The facts are, and that is why I later made a ruling, was that he did not really comply in all respects with what we told him to do. In addition, the number of machineguns involved was substantial—not only the small number he had, but he had obtained additional machineguns. It became obvious to me from my own personal observation, as these things began to turn up in substantial use in criminal hands, that they were very easy to put back into operable condition. So it was necessary to change the ruling.

ATF/S. BRYGIDER CORRESPONDENCE

Senator McClure. I have a copy of a letter written to Mr. Sanford L. Brygider, president of the Bingham, Ltd., in Atlanta, Ga., signed by Mr. Darren Dobbs, then Acting Director of the National Firearms Branch of BATF, that was in response to a telephone conversation on September 28, 1979. He gave detailed instructions as to how such a machinegun, to be removed from the provisions of the National Firearms Act, must be treated. He gave step-by-step instructions as to what must be done. That was, I understand, received by Bingham, Ltd., on October 9, 1979.

On November 15, 1979, a letter was hand delivered to indicate that BATF had reclassified these kits as firearms under title I of the Gun Control Act of 1968, making them subject to interstate transfers only through holders of Federal firearms licenses, and in effect reversing that direction that had been given about a month earlier.

I don't see anything in the information that has come to my attention that indicates that the sales that took place in the interim were not in compliance with the directions that had been given in September.

Mr. Dickerson. Senator McClure, there were indications that the individual first failed to comply with our instructions.

Senator McClure. Could you provide to me and for the record the details of the manner in which he failed to comply with the September instructions?

Mr. Dickerson. Yes, sir. I was going to suggest I do that. I have some papers prepared for the briefing this afternoon. I don't have those books with me.

[The information follows:]

BACKGROUND REGARDING MAC-10'S AND S. BRYGIDER

In March of 1978, we received a letter from Wayne Daniel, Precision Armament, Inc., Avondale Estates, Georgia, in which he asked us to approve a proposed method of destruction for MAC-10 machinegun receivers. Mr. Daniel explained that he had a few registered receivers which he wanted to destroy and sell as wall ornaments and paperweights. The proposed method of destruction involved cutting the receivers into seven pieces.

On May 2, 1978, we advised Mr. Daniel that the proposed method of destruction would be acceptable.

Subsequently, these receivers appeared on the commercial market in large quantity combined with all component parts necessary to assemble a functional machinegun. Furthermore, the receivers, which were being sold, consisted of new components which had never been assembled, serialized, or registered. The receivers were also cut into five pieces instead of seven pieces as had been specified. Two major components of the receiver which originally were to have been removed by cutting, were in fact never installed and were supplied intact with the kit. It was apparent that these kits were not intended for use as wall ornaments and paperweights and that they were, in fact, intended to be assembled into machineguns. Our investigation then revealed that these kits were readily being assembled into functional machineguns in violation of the provisions of the NFA. On November 15, 1979, we advised Mr. Daniel that the unfinished receivers, which had been cut, could be readily converted to functional condition; therefore, they qualified as firearms as defined in Title 18, U.S.C., Chapter 44, Section 921(a)(3). Furthermore, the cut receivers and the component parts kits constituted a combination of parts from which a machinegun as defined in Title 26, U.S.C., Section 5845(b).

Consequently, on September 1979, Mr. Brygider contacted the National Firearms Act Branch by telephone, and requested that we provide instructions for destroying a quantity of MAC-10 receivers. On October 5, 1979, we provided Mr. Brygider with the same destruction procedure which had been given to Mr. Wayne Daniel.

On October 31 and November 6, 1979, Mr. Brygider advised ATF in writing that he had destroyed a total of 210 receivers according to the described method.

Following our re-evaluation of the destruction method as proposed by Wayne Daniel, special agents of the Decatur, Georgia, Post of Duty, advised Mr. Brygider that the destruction method as described earlier was no longer acceptable. We had determined that these receivers could be readily restored to operating condition. He was also advised that he could dispose of the receivers in accordance with the provisions of the NFA or subject them to further modification.

Examination of the facts involving this situation reveals that Mr. Brygider did comply with the instructions given by ATF. It was Mr. Daniel who had misinformed us regarding his intentions and had failed to advise us that the cut-up receivers were to be sold in conjunction with a complete component parts kit. Nevertheless, once we had re-evaluated our position regarding the status of the cut receivers, we immediately notified Mr. Brygider of our position.

A letter formally advising Mr. Brygider of the status of the receivers was initiated immediately following the verbal notification by the special agents of Decatur, Georgia. This letter was ready for delivery on December 13, 1979. This letter was not sent, however, because it was not responsive to a letter which had been received from Mr. Brygider in which he asked numerous questions including a request for an alternate method of destruction. After several revisions to incorporate all the information requested, a final revised letter was ready for delivery on March 31, 1980.

Mr. DICKERSON. The other point is once we reclassified the weapon as restorable or the kits as restorable to machineguns, they did then become illegal in the possession of people who had them. So we moved to try and recover those as well as to stop any further distribution.

Senator MCCLURE. I understand that. But on November 15, the same time that the second letter was delivered to Mr. Brygider, you also directed a letter to a Mr. Wayne Daniel of RPB Industries in Atlanta, Ga., in which you suggest there are further ways it could be modified to make such sales and possession legal. Excuse me, I shouldn't have used that term because the sale could be legal. Let's say so they would be removed from the provision of the Firearms Act.

You specifically state in that, Mr. Dickerson—it is over your signature—that:

> Should you desire to continue the sale of the destroyed M-10 or M-11 submachinegun receivers, we will be happy to provide additional instructions for more complete destruction of the receivers.

As I understand, Mr. Brygider wrote to you on November 20, which would just be 5 days later, after the date of that letter, and requested those instructions. He received no answer to that letter until he again contacted you some 4 months later.

Then you replied indicating that if one portion of it is completely removed, then the sale and possession would not come within the National Firearms Act.

Am I substantially correct in what I have recited here?

Mr. DICKERSON. I think you are, Mr. McClure. I don't have the record in front of me, but I am sure you are.

Senator MCCLURE. If you find any reason to believe it is inaccurate in any essential details, I wish you would correct it or provide for the record the correct sequence of events and the correct identification of what actually did happen.

I also have a copy of the BATF's factsheet which was handed out to individuals who were given three options in that factsheet. Those are people who had purchased the kit that had been sold. They had been destroyed; they had been cut up; they had been sold pursuant to your instructions.

You obtained, as I understand, a listing from the shipper of the people who had received those and attempted to contact the people to whom they had been sold and gave them a factsheet in which they were given three choices. One, abandon the weapon to BATF; two, donate the weapon to a museum, which is a part of a Government entity; or three, transfer the weapons to a local or State law enforcement agency willing to register them with ATF.

Now there is a fourth option, at least I would think, and that is to exercise the option under your November letter to render them inoperable in a way satisfactory to you so they wouldn't have to give up something which they paid for. There was no offer in this factsheet from ATF to reimburse the people who bought them in good faith. There was no indication that there was any option that they had other than to surrender without compensation something which they had bought which was at the time they purchased it pursuant to your instructions. Am I not correct?

Mr. DICKERSON. Yes, sir, you are.

Senator McCLURE. Sure, you have the right to change your mind. You even have the right to say, "Gee, we goofed. We blew it." Perhaps you did on the first instruction.

But doesn't the Government have some responsibility to people who in reliance upon Government instructions make an investment, pay some money—not much money, but some money—and to some of the people who bought it a couple hundred bucks is a couple hundred bucks. They are not getting checks from the Government. This comes out many times from money they earned and it is hard-earned money.

It seems to me in some kind of fairness to them, if there is a change on the part of the Government in that what is said before doesn't apply now, the Government has some responsibility there. Don't you believe that is correct, Mr. Dickerson?

Mr. DICKERSON. I certainly agree with you that there are people who unwittingly lost money when they thought they were doing something that was correct. Unfortunately, I am not aware of any basis on which the Government could reimburse them. I will certainly look into it to see if there is any opportunity for doing so or any obligation for doing so.

[The information follows:]

POLICY REGARDING REIMBURSEMENT OF FIREARMS FORFEITED

After carefully researching this matter, I find that the Bureau is unable to reimburse persons whose National Firearms Act firearms have been lawfully forfeited because the persons formerly possessing them acquired the weapons in good faith but without registering them in accordance with the Act.

As you are aware, sums appropriated by Congress must be applied solely to the objects of such expenditures and appropriations not used for the specific work designated by Congress cannot be used for any other purpose. 31 U.S.C. Section 628, *Valley Construction Co.* v. *Hoffman*, 417 F. Supp. 926 (N.D. Ga. 1976). The Bureau's current appropriation provides funds for: "Necessary expenses of the Bureau of Alcohol, Tobacco and Firearms including purchase of . . . and hire of passenger motor vehicles; hire of aircraft; and services of expert witnesses at such rates as may be determined by the Director;" Public Law No. 96–74, 93 Stat. 560.

The Comptroller General has long held that where an appropriation is made for a particular object, by implication it grants authority to incur expenses necessary, or proper, or incident to the proper execution of the object in the absence of another appropriation which makes more specific provision for such expenditures, or unless they are prohibited by law. 29 Comp. Gen. 420 (1950). Since none of the specific authorizations in the Bureau's appropriation authorize expenditure for reimbursement to persons whose National Firearms Act firearms have been lawfully forfeited, such an expenditure can only be justified if it is determined to be a "necessary expense".

The Comptroller has construed "necessary expense" for purposes of availability of funds as "referring to current or running expenses of a 'miscellaneous character arising out of and directly related to the agency's work * * *.' " 52 Comp. Gen. 504 (1973). Where an expenditure "would have no direct connection with or be essential to the carrying out of the stated general purpose for which the funds were appropriated" the expenditure may not be considered a "necessary expense". Id. In 52 Comp. Gen. 504, *supra*, the Comptroller was asked to rule on whether the purchase of Christmas trees and decorations by the Bureau of Customs was a "necessary expense". The Comptroller indicated that while the trees and decorations may have enhanced the appearance of rooms or offices, the purchases bore no direct connection with nor were they essential to the carrying out of the purposed for which the funds were appropriated. Thus, the Comptroller determined that they were not "necessary expenses". Likewise, while reimbursing persons who have had machineguns lawfully forfeited because they purchased them in good faith but without complying with the registration requirements of the National Firearms Act would seem to comport with fairness, such expenditures could not be considered current or running miscellaneous expenses arising out of, and directly related to, the Bureau's work. Further, they do not have a direct connection with, nor are they essential to, carrying out the stated general purposes for which the Bureau's funds are appropriated. Thus, we are without authority to expend appropriated funds in this manner.

It was an enforcement decision, but it was one in which I felt the need to protect the public interest was so great, we should take this action.

MACHINEGUN POLICY

Senator McCLURE. What is your policy with respect to the latter portion of the machinegun section, that it could be rendered inoperable? Here you have said to these people, "All right, you can cut that receiver in four pieces, remove materials," and then you find well, somebody with machinegun shop skills can go back and weld it back together and render it an operable gun and, therefore, it is a machinegun within the prohibition of the statute. How far does that go?

Mr. DICKERSON. The action that is taken should go far enough as to make it not impossible but extremely difficult for someone to put the machinegun back into use.

Senator McCLURE. What is extremely difficult?

Mr. DICKERSON. I could give you some of the legal decisions we have on that. Again, unfortunately, I don't have that in front of me. I would be glad to elaborate.

[The information follows:]

ATF POLICY REGARDING INOPERABLE FIREARMS

Unserviceable National Firearms Act firearms which are incapable of discharging a shot by the action of an explosive and incapable of being readily restored to firing condition are still subject to the provisions of the NFA. However, we recognize that there must be a practical means of destroying firearms short of complete smelting. Once a firearm has been cut, mutilated, or mangled to such an extent that it is useless as a firearm and is impractical to restore to operating condition, it may be considered destroyed.

Due to differences in firearm design and construction, a particular destruction method which may be acceptable for one type of firearm may not be acceptable for another.

In the case of the cut-up MAC-10 receivers, it became apparent that these receivers could still be readily restored to functional condition and that fact makes them of value to anyone who wishes to manufacture a machinegun. Our reclassification of the cut up receivers does not affect the ability of an individual to legally receive or manufacture a MAC-10 machinegun.

Senator McCLURE. The thing that concerns me is I am an owner of a Mossberg semiautomatic .22 caliber which I have had for about 40 years. I can render that fully automatic very easily. Now you know that is a fact, don't you?

Mr. DICKERSON. Yes, sir.

Senator MCCLURE. I am not asking you to know that it is a fact on my Mossberg, but on many semiautomatics—any auto reload rifle or pistol and those things which are called semiautomatic—many of them very easily could be rendered fully automatic; isn't that correct?

Mr. DICKERSON. That is correct.

Senator MCCLURE. Are you going to prosecute me——

Mr. DICKERSON. No, sir.

Senator MCCLURE [continuing]. For having one that could be readily converted?

Mr. DICKERSON. There is another provision of the law which relates to weapons that are prepared for semiautomatic use. Your weapon would not meet the criteria unless it had been converted to fire in the fully automatic mode.

Senator MCCLURE. That MAC-10 takes more labor to reconvert it to operable condition than it would take to convert my semiautomatic .22 caliber to fully automatic.

Mr. DAVIS. That may take more time, Senator, but it certainly didn't take that much time. A lot of them did show up. They showed up on the streets of Miami and they showed up in a way where they were used similar to the use in "The Untouchables" show on TV. This not only provides risk to the people who are shooting each other but to the people who are around them. So I think in this particular case it turned out that that MAC-10 was not that hard to put back together.

Senator MCCLURE. Incidentally, I suspect the MAC-10 you showed us today is not one that has been cut apart, chopped up, and then welded back together; am I correct?

Mr. KEATHLEY. That is correct.

Senator MCCLURE. That is in its original condition?

Mr. KEATHLEY. Yes, sir.

Senator MCCLURE. But what is the standard? Am I different than the owner of a MAC-10 that has been chopped apart?

Mr. HIGGINS. Yes, you are.

Senator MCCLURE. In what way? I am obviously a Senator of the United States.

Mr. HIGGINS. In more ways than that. We will provide more specific information.

[The information follows:]

CONVERSION OF MOSSBERG .22 CALIBER RIFLE INTO A MACHINEGUN

As defined in title 26, U.S.C. Section 5845(b) the term machinegun includes any weapon which shoots, is designed to shoot, or can be readily retored to shoot, automatically more than one shot by a single function of the trigger.

The Mossberg .22 caliber rifle would not meet this definition unless it had been converted to fire in the full automatic mode. Although the described rifle could possibly be converted to a full automatic more easily than one could assemble a MAC-10 machinegun kit, the fact remains that the MAC-10 machinegun is designed to shoot automatically. The receiver of a MAC-10 is a machinegun. The cut-up receivers and the component parts kit constitute parts from which a machinegun can be assembled, and the registered, cut-up receivers can be readily restored to operating condition; therefore, they are still machineguns.

In one case you are talking about a weapon that was designed not as an automatic weapon. The gun you are talking about is designed as a semiautomatic weapon. The fact that it could be readily converted into an automatic weapon, it is still legal until such time as you do that.

The other type of gun we are talking about started out as a controlled—not an illegal weapon—but it is a controlled weapon. It started that way. It was then cut, and the law says that it can't be readily restorable.

We are talking about two kinds of guns—one that was originally designed to be fired automatic and the other that wasn't.

Senator McCLURE. How about those that are not designed to be fully automatic but can be converted? You are telling me then there is a different standard?

Mr. HIGGINS. Yes, sir.

Mr. DAVIS. The statute provides a different standard.

Senator McCLURE. How about the fellow with an old Nobel shotgun who was prosecuted by your agents because there is a kit available which he did not have, but there is a kit available by which it could be rendered fully automatic? You prosecuted and convicted him.

Mr. DICKERSON. It doesn't sound like that would be a basis for conviction.

Senator McCLURE. It doesn't sound like it to me, but the poor devil that was prosecuted and convicted is now a convicted felon in the United States because of the actions of your agency based upon what you tell me would not be done.

Mr. DICKERSON. Senator McClure, if you would give me the name and other information, I would be glad to look into the situation. The facts as you described them would not be a basis for that.

Senator McCLURE. That is Canton Zaro, a Connecticut man, a Nobel shotgun, long off the market, missing a lot of parts required even to make it an operable firearm. BATF witnesses testified since they were able to track down a very obscure firm that sold the type of parts which were missing from the defendant's gun, the defendant could have done the same thing. BATF, in making its case, claimed that it only took 1 hour to restore the defendant's firearm to operable condition, although there was no evidence that the owner of that firearm even knew that the parts were available let alone had them.

Mr. DICKERSON. I will be glad to look into the case, Senator McClure.

[The information follows:]

CANTON ZARO CASE

ATF has investigated and searched through its' files and has no record of any such individual.

CONVERSION OF AR-15

Senator McCLURE. I guess what I am getting at is it seems to me there needs to be some kind of a standard by which citizens of this country can know when they are doing something which is legal and know if as a matter of fact they are doing something that is illegal. If we can't meet that test, it seems to me we are doing something that is fundamentally violating the rights of the people who are not using MAC-10 machineguns in street crime.

I am not insensitive to the use of machineguns in street crime. I think every one of us wants to get at that. But what are you doing about an AR-15? Are you familiar with ads that have appeared in recent trade journals about the conversion of the AR-15 by the purchase of an auto receiver?

Mr. Dickerson. Yes, sir. I am familiar with it.

Senator McClure. The Shotgun News edition of March 15 shows that the South Central Research Corp., post office box given as Katy, Tex., can convert that into a fully automatic weapon by just buying their kit. Are you moving against that organization? Do you know anything of them?

Mr. Dickerson. No, sir. I am aware of the ad. I have received letters from people saying we should do something about it. There is no legal basis we have.

Senator McClure. There is no legal basis to move against them? I thought you told me just a moment ago that was a controlled firearm.

Mr. Dickerson. No, sir. I did not tell you that.

Senator McClure. The MAC-10 kit is not illegal?

Mr. Dickerson. The MAC-10 at onetime had been. The difference was in one instance, you were dealing with what was manufactured as a machinegun which then was partly nil and restorable as a machinegun, as against a machinegun such as the AR-15 manufactured as a semiautomatic.

Senator McClure. What is the difference between the AR-15 and the M-16?

Mr. Dickerson. The AR-15 can be converted from what it was manufactured for, as a semiautomatic weapon, by a conversion kit into the automatic weapon.

Mr. Davis. I share with you a certain astonishment that we cannot do anything about the fact a weapon can be so readily converted to automatic and used for criminal purposes. But if that is the law, that is the law.

Senator McClure. If as a matter of fact we followed the distinction which you have made, are you going to change your mind next month and start prosecuting the purchasers of the AR-15 kit?

Mr. Dickerson. The situation is not similar to the one under the law related to the MAC-10. So I am not contemplating any change which would in any way jeopardize people in possession of the AR-15.

Senator McClure. Even if they purchase the kit?

Mr. Davis. Senator, one has to be careful. There may be a large variety of factual situations that may come up. I think you put your finger on it, that the important thing would be notices of our proposed changes, if there is going to be a change, to give people notice so you don't retroactively apply some rules. I agree with you that is important.

It is difficult now to give you rulings on a large variety of situations. However, we will give advance notice of our proposed revisions in this area.

Senator McClure. You have indicated there is a standard which you are following. I assume in answering the inquiries I may get or anyone else may get we can publish that standard or at least repeat that standard and not put them in the jeopardy of being prosecuted by your agency, at least until there is some notice that you are going to do it differently; is that correct?

Mr. DICKERSON. Yes, sir. That is correct. I think, Mr. McClure, it is a very complex law. We are not trying to say it is simple or even trying to say it is correct in every case. It is a complex law. I intend to try and prepare some documentation to make it as simple as possible and distribute that documentation and make it available to those who may be interested. So we will try to do that.

SALE OF MAC-10 KITS

Senator McCLURE. In the one instance which we have identified, you said you will move against sale of the MAC-10 kit under the applicable provisions. I find it a little difficult to use terminology because it is not illegal under every circumstance; it is only illegal under some circumstances defined by the statute and subject to those regulations, licensing and tax provisions. Yet the MAC-10 lower receiver kit is being advertised and sold today, is it not?

Mr. DICKERSON. I don't know whether it is or not, Senator.

Senator McCLURE. I will refer you to the March 15 issue of Shotgun News published in Hastings, Nebr., in which there is a half page ad of the Shooters Equipment Co., Tamassee, S.C., reference South Carolina National Bank, in which they say, "Why waltz when you can rock and roll? MAC-10 lower receiver kits now available. Build your own submachinegun or semiautomatic pistol at home in just a few hours," et cetera. That goes for half a page.

Mr. DICKERSON. I will submit a comment on that.

Senator McCLURE. I will give you a copy of it if you don't have it.

[The information follows:]

COMMENT ON SHOTGUN NEWS MAGAZINE AD

The Shooter's Equipment Co. of Tamassee, S.C., is owned and operated by Gordon T. Davis and A. Robert Deter Jr. They have no Federal firearms license but advertised and sold MAC-10 lower receivers and lower receiver kits consisting of a lower receiver blank, a set of five drill bits, a template, and an instruction booklet.

ATF agents purchased one kit for examination purposes and on April 2, 1980 notified Mr. Davis that the MAC-10 lower receiver was a firearm under title I of the Gun Control Act (GCA). Mr. Davis was advised that he needed a Federal firearms license to engage in the business of selling the lower receiver blanks and that each firearm had to bear a serial number and be controlled in the same manner as any other firearm.

Senator McCLURE. P. J. Sullivan Co. of Atlanta, Ga.

Mr. DAVIS. Again, Senator, I assure you the decision, as the Director said, has been made and was made last fall about the MAC-10. It was made with some publicity. What we say here should not be taken in any way as sanctioning the legality of anybody placing that ad. I may not be in a position to comment now, but I thought that ought to be clear.

Senator McCLURE. I certainly don't want to indicate that just because you haven't acted against them you have said somehow it is all right. I am not saying that. If you think indeed there is a problem with

MAC-10 machineguns out there, it would seem to me it is easier to stop the creation than it is to try to trace them down afterward and bust the guy who bought them. There is at least some implication that if it is done in interstate commerce, freely and openly and publicly, that the Federal Government has taken no action against it, that some people might be misled.

Mr. DAVIS. The difficult position we are in is we cannot even make comments as to whether there is an investigation.

Senator MCCLURE. The Group Ltd., Calif., a similar ad.

I would hope you would get back to me as to what you can say about those ads and those sales.

Mr. DICKERSON. Yes, sir. We will be glad to try and do that.

[The information follows:]

COMMENT ON OMEGA GROUP, LTD. AD

In response to the March 15, 1980 ad in the Shotgun News advertising the sale of MAC-10 receivers by the Omega Group, Ltd. of Sacramento, Calif., ATF Firearms Technology Branch requested the submission of a prototype from Omega for examination purposes.

David H. Erickson of Omega Group, Ltd. provided one MAC-10 lower receiver to ATF for examination and was later advised that he also would need a Federal firearms license to engage in the business of selling the MAC-10 receivers. He elected to abandon his stock of 112 MAC-10 receivers rather than submit to Federal licensing provisions.

Senator MCCLURE. Thank you, Mr. Chairman.

Senator CHILES. I have some other questions I want to submit for the record as well as some submitted by Senator Laxalt. We have a couple of other witnesses. Thank you for your appearance here today.

[The information follows:]

QUESTIONS SUBMITTED BY SENATOR CHILES

ATF SPLIT ORGANIZATIONALLY IN TWO HALVES

Question: Mr. Dickerson, I understand that you are attempting to bring ATF together into one organization. Currently the Law Enforcement side of ATF and the regulation side of ATF have different field structures. For example, the Law Enforcement side has four regional headquarters and the regulation side has seven regional headquarters with no unified command structure until your Deputy here in Washington.

Couldn't we get more effective use of ATF resources if the Agency were put together organizationally? For example, it seems to me that those involved in the regulation of firearms should be working closely with those involved in the Law Enforcement aspects of firearms.

Answer: While our present Headquarters and regional managers have demonstrated the ability to work together effectively despite the difference in field structure, such a situation does at least create a potential source of trouble. Accordingly, my staff recently completed an internal study aimed at determining whether a common regional structure for all functions might improve our effectiveness, and, if so, the optimum number of regions. I am presently reviewing their recommendations.

With respect to the need for unifying all functions under one position in the region (e.g. a Regional Director) as you know that was the structure the Bureau had until the Regional Director positions were abolished in 1976. It was felt at that time that the field was not responsive enough to national direction. While our experience to date has shown that our regulatory and law enforcement functions can work closely together without reporting through a common regional official, I nevertheless intend to closely monitor the situation and would not be reluctant to recommend re-institution of the positions should any serious problems develop.

FREQUENT REASSIGNMENT OF ATF MANAGEMENT

Question: Mr. Dickerson, I am sure you are aware of the frequent reassignment of ATF agents who are in the Career Program. In fact, the committee has been informed that increasing numbers of very well qualified ATF agents are refusing to enter the career program because they do not want to be relocated around the country every few years.

Answer: The Office of Criminal Enforcement has been constantly attempting to improve not only the ATF Career Program, but the transfer policy in general. This office has recently established a District Office of Preference for career employees. The Bureau has 31 district offices across the country which afford the employee a close geographic location of his/her choosing. The office of preference is subject to budget limitations and personnel needs. Additionally, there are no guarantees that a special agent will be assigned to the district office of his/her choice, but the possibility exists that, should a reassignment occur, it would probably only involve those agents who have expressed a desire for that location.

This office has also established a Hardship Review Board to consider reassignment requests of special agents, based upon certain personal hardships. The board consists of the Deputy Assistant Director and four Regional Directors of Investigations. The board convenes on a quarterly basis to consider all applications. Every effort is made to accomodate these requests, again, dependent upon the availability of positions, moving funds, and personnel needs within the requested area.

Within the career program, this office has established a vacancy preference procedure for those candidates under consideration for promotion. Before selection, each candidate is contacted and appraised of the position grade, title, and location of all vacant positions. The candidate is given the opportunity to express his/her degree of interest.

Question: Mr. Dickerson, what is the purpose of these frequent relocations?

Answer: The Bureau's transfer policy for special agent personnel has historically been based on the geographic deployment of personnel in relation to the high potential criminal investigative workload. This strategy requires personnel shifts as changes occur in legislative responsibilities, crime indices, and population.

The current career program was implemented in 1976. The purpose of the program was to create the opportunities and diversity of experience for the most qualified candidates desiring to progress upward in management positions within the Bureau.

In attempting to provide those candidates with diversification of experience, relocations have become a necessity. The career program begins at the first supervisory level and continues upward to include the special agent in charge and Headquarters division chief positions.

Normally, when selecting at the first supervisory level, we have found it desirable to transfer the selectee, even though a similar position is vacant at the same office.

When a candidate is chosen to fill a vacancy in his same office, great hardship is often created for the newly appointed supervisor in adequately controlling those employees who, days earlier, were his peers, personal friends, competitors, and in some instances, his antagonists.

This situation does not exist in higher positions; e.g., an assistant special agent in charge. Occasional moves involving special agents are necessary to protect their personal safety.

Question: While there are complaints about this relocation policy, we understand that the number of relocations per year has remained relatively constant over the last several years. Is that correct?

Answer: That is correct.

Question: Please provide for the record the number of ATF changes in duty stations in fiscal years 1977, 1978, 1979, and projected for 1980 and 1981. What is the average cost of these moves?

Answer: During fiscal year 1977, Criminal Enforcement made a total of 111 permanent change of station (PCS) relocations. (Data is not available on the number of career program versus programmatic PCS relocations.)

During fiscal year 1978, Criminal Enforcement made a total of 105 PCS relocations. (Data is not available on the number of career program versus programmatic PCS relocations.)

During fiscal year 1979, Criminal Enforcement made a total of 122 PCS relocations. Some 76 of these, or 62 percent, involved career employees.

Thus far during FY1980, Criminal Enforcement has made a total of 51 PCS relocations. Some 41 of these, or 80 percent, involved career employees. Fifteen (15) allowable PCS relocations remain in the FY1980 budget.

For FY1981, Criminal Enforcement projects the need for 115 PCS relocations. Of this number, 54 would involve career employees. The balance consists of programmatic PCS relocations, opening and closing of field offices, retiree replacement, etc.

The FY1980 average cost of these transfers, is $12,500.

ALLEGATIONS OF FRAUD BY ATF EMPLOYEES/ EFFECTIVENESS OF ATF INTERNAL AUDITS

Question: Based on a recent review by GAO, ATF internal audits over the last 3 years of the criminal enforcement area disclosed that almost all were investigations of imprest funds. Why has the audit activity focused almost exclusively on imprest funds? Please describe the number and nature of the internal audits done on the Regulatory side of ATF.

Answer: Audit coverage has not focused on imprest funds but rather has been broad, covering systems and operations which are the responsibility of criminal enforcement and which have a significant impact on effective accomplishment of the mission. We do not feel that the number of audits of the criminal enforcement areas is adequately reflective of the extent or quality of audit coverage. In terms of the overall number of audits, imprest funds may appear to dominate. However, regular independent audits of these funds are required of all agencies of Government by fiscal regulations issued by the Treasury Department.

To measure the adequacy of audit coverage, we believe it is necessary to evaluate the audit scope and amount of staff resources expended in audits of various functional areas as well as audit results. During fiscal years 1977 through 1979, full scope audits of criminal enforcement responsibilities accounted for more than three times as many staff days as audits of imprest funds.

During fiscal years 1977 through 1979, 12 internal audits were initiated and 10 were completed covering various aspects of regulatory enforcement operations and activities. These audits were predominantly program evaluations appraising operations in connection with revenue protection inspections, resolution procedures for violations of the IRC and FAA Act, firearms licensing activities, excise tax drawback claims, administration and in-bond transfer activities.

Question: It appears none of the criminal enforcement audits involved economy or efficiency reviews. Why doesn't the audit function perform program evaluations of criminal enforcement responsibilities?

Answer: Program evaluation audits of criminal enforcement responsibilities are an integral part of our internal audit program at ATF. The scope of audits listed below by fiscal year included evaluation of the economy, efficiency and effectiveness of systems and operations for which the criminal enforcement activity is responsible and resulted in recommendations for improvements in the management of the programs which were implemented by the Bureau.

Fiscal year	System, Operation or Program Audited
1976	Seized Property Activities
1976	Project Concentrated Urban Enforcement (CUE)
1977	Treasury Enforcement Communications System (TECS)
1978	Investigative Equipment Management
1978	Relief from Disability Administration
1979	Management of Administratively Uncontrollable Overtime (in process)

Question: The committee has heard reports of alleged fraud by ATF employees in the New York-New Jersey area. Are there currently grand jury proceedings underway on these matters?

Answer: The Office of Internal Affairs is currently conducting an investigation in the Judicial District of New Jersey in which fraud on the part of regulated industries has been alleged. A representative of the United States Attorney's office in Newark has requested that all inquiries with respect to the progress of the investigation be referred to that office.

Question: In view of these problems, do you believe that it would be desirable to create a stronger Inspector General function at Treasury?

Answer: The current organizational structure of the Office of Inspector General in Treasury adequately meets the needs of ATF and should not be changed at this time. Treasury historically has been organizationally decentralized, therefore, a decentralized inspection function is totally consistent with this philosophy. Since Treasury agency heads are held responsible for the administration of their programs, they must have the capability to ensure the integrity and compliance of these programs. Direct access to an inspection function provides this capability.

The diversity and sensitivity of Treasury program responsibilities makes it necessary to have indepth understanding of the intricacies of the organization to enable effective oversight. In our judgment, a decentralized organization is the only way to ensure that this is achieved. The current structure, particularly in light of the recently issued Treasury Department order requiring direct reporting of inspection heads to the Inspector General and the oversight responsibility that rests with that office, more than adequately ensures independence, objectivity, coordination and efficiency. Before any more changes are made in this arrangement, we should allow it to function for a period of time to determine if additional adjustments are necessary.

ARSON

Question: As you know, the Committee requested OMB last year to initiate and coordinate a Federal level review to address the appropriate role of the Federal Agencies with regard to the arson problem.

That report found that there is a lack of conclusive evidence of the magnitude, growth, and nature of arson; there is substantial disagreement regarding the principal causes of arson; there are 8 federal agencies with antiarson programs spending approximately $15 million a year on the problem; and preliminary evidence indicates that arson related losses are declining.

Answer: The arson report prepared by the Office of Management and Budget (OMB) is basically non-conclusive, containing more supposition than fact. The principal statistical figures upon which the report bases comments relative to the magnitude, growth and nature of arson, as well as an indicated decline in arson related losses, were extracted from 1977 information collected by the American Insurance Association (AIA); 1978 information collected by the National Fire Protection Association (NFPA); and a 1979 report prepared by the Law Enforcement Assistance Administration (LEAA). Regarding the reference to the AIA figures versus the NFPA figures, the report states that definitional and other statistical problems make comparisons between these figures difficult. The Bureau of Alcohol, Tobacco and Firearms (ATF) has determined that the 222,000 arson incidents reported by NFPA in 1978 included both vehicle and structural fires, while the property loss figure of $1.0 billion related only to structural arson incidents. Actually, of the 222,000 arson incidents reported by NFPA in 1978, 174,000 related to structural fires which resulted in property losses of $1.03 billion. In the 1979 report prepared by LEAA, there were approximately 212,000 suspected arson incidents resulting in $1.2 billion in property losses, and all of these incidents related to structural fires. Hence, if a comparsion were made between the structural arson fires and resulting property losses as reflected in the 1978 NFPA statistics and the 1979 LEAA report, there was an increase of 38,000 structural arson incidents and an increase of $.2 billion in property losses resulting from such incidents.

The comments reflected in the OMB report relative to substantial disagreements regarding the principal causes (motives) of arson were based upon the results of a questionnaire survey conducted by LEAA. The LEAA questionnaire was mailed to approximately 435 cities and responses were received from 174 of these cities. However, of the 174 respondents, only 16 of the cities completed the portion of the questionnaire related to motives for arson. Hence, the "motive results" reflected in the LEAA study were based upon an extremely small sample.

The OMB report indicated that there are approximately eight Federal agencies involved in anti-arson programs, resulting in expenditures totaling approximately $15.5 million in FY1980. However, in FY1981 no anti-arson support funds are expected from LEAA, meaning that other Federal agencies (such as ATF) will be called upon to provide greater assistance in training to State and local authorities.

In conclusion, ATF agrees with the basic premise of the OMB report, in that more comprehensive, specific, comparable data may be needed in order to effectively evaluate the increase/decrease of arson incidents occurring in the United States. But even if we assume that minimum current data reflected in the OMB report is reasonable (i.e., 174,000 structural arson incidents in any given year, 14 percent of which are "profit motivated"), we can estimate that some 24,360 "arson-for-profit" crimes, directed toward structural targets, are subject to occur on an annual basis. This figure in itself indicates a significant problem that must be addressed through the combined efforts of responsible Federal, State and local law enforcement agencies.

Question: As you know, the FBI also has an investigation and prosecution program aimed at the large scale organized crime figures involved in arson. How is the BATF's arson investigation and prosecution program coordinated with the FBI's?

Answer: ATF is committed to the assistance of all law enforcement agencies in the continuing fight against crime and violence. As we understand it, the Federal Bureau of Investigation (FBI) arson program focuses on those activities involving known organized crime figures, as well as providing training/laboratory support to State/local agencies, and certainly their program is vital to the success of the overall law enforcement effort being directed toward arson crimes. But beyond our own training and laboratory support to other enforcement agencies, we in ATF believe that we have jurisdictional authority under the Gun Control Act of 1968 and the Organized Crime Control Act of 1970 that provides us with the means whereby we can effectively fight, and support the fight, against the volume of "arson-for-profit" crimes being committed in America today. We realize that we cannot, and should not, attempt to address the totality of arsons; but within the framework of our defined arson enforcement program, and through a commitment of reasonable staffyears and budget resources necessary to support that program, we must strive to uphold our Federal responsibilities in combating our nation's arson problem.

The Bureau of Alcohol, Tobacco and Firearms (ATF) coordinates arson related investigation with the Federal Bureau of Investigation (FBI) at the field level on a case-by-case basis. The major thrust of our arson enforcement program is directed toward "arson-for-profit" crimes (the target of which are industrial/ commerical activities) perpetrated by members/associates of organized crime, white collar criminals, and members/ associates of organized "arson rings"; and assistance to State/local agencies experiencing a significant arson problem especially when the nature or magnitude of the problem extends beyond the jurisdictional or resource capabilities of such agencies.

The direction of our investigative efforts, coupled with the FBI's interest in arson incidents involving known organized crime connections, have resulted in some situations wherein the jurisdictional authority of the two agencies have been used to compliment one another in the successful prosecution of defendants. Through our Arson Task Force efforts, and other cooperative endeavors, such joint investigations are conducted when appropriate; however, in the overwhelming majority of cases, ATF has been the primary Federal agency involved in the pursuit of arson violations that fall within the purview of our defined enforcement program.

Question: The Bureau currently has approximately 160 positions and $6.3 million focused on the arson program in Fiscal Year 1980 and proposes through reprogramming to add another 19 positions and over $800,000 to the program in Fiscal Year 1981.

In view of the declining arson related property losses and the FBI program, why is BATF continuing to increase its arson program?

Answer: As stated above concerning arson statistics, the Bureau has not been provided with any conclusive evidence that arson-related property losses are in fact declining. ATF feels there is a demonstrated need for Federal involvement and that statutory authority vested in ATF, provides an opportunity for Federal impact.

Question: How big does the Bureau project the ATF arson program to be in five years? In 10 years?

Answer: Looking ahead five to ten years, we are faced with numerous unknown factors, such as: the condition of the nation's economy; the probability of new legislative actions; and/or the viewpoint of judicial decisions at the Federal or State levels. Therefore, we do not anticipate any major changes in program emphasis until legislation is developed, policy guidance is received by OMB, and/or our own arson program can be evaluated further. But, we are confident that appropriate Federal emphasis /assistance is necessary to support the efforts of State and local authorities, and we believe that the Bureau of Alcohol, Tobacco and Firearms (ATF) can make a meaningful contribution to the type of coordinated approach required to address the identified arson problem.

Within the framework of our present resource capabilities,we will continue to pursue selected investigations through our Arson Task Force concept; provide national response capabilities through our arson/explosives response teams; and provide training/laboratory support to other enforcement agencies. In doing so, we will strive to ensure maximum results through the efficient utilization of available resources.

GASOHOL

Question: President Carter has announced a program to produce 500 million gallons of gasohol annually, up from the current production of 80 millions gallons. According to the justification material the Bureau received over 3,300 gasohol related applications in fiscal year 1979 and only approved approximately 700. Why were so few of these applications approved?

Answer: More than twice that number were issued permits. In calendar year 1979 ATF received 4,294 applications for alcohol fuel plants. Only 51 of these applications were for commerical plants. The remainder 4,243, were for experimental permits which authorized fuel production for personal use only. The disposition of these applications was as follows:

Experimental permits issued	1,517
Experimental applications withdrawn or abandoned by the applicant	700
Experimental applications denied	2
Pending further action by the applicant	2,024

ATF reduced the application requirements for the experimental permit to the minimum required by law. The law also required the applicant to post a bond. ATF waived an application inspection in most cases to expedite issuance of the permits. Only when the applicant failed to furnish the required information or post the required bond was ATF unable to promptly issue a permit.

For commercial applications, only 3 permits were issued in 1979. Applicants withdrew 5 applications. By law, ATF cannot issue a commercial permit until the plant has been constructed. Many applicants were from 6 to 24 months from completion of their plant.

We do not feel that there is any backlog of applications for alcohol fuel permits. We have taken all possible lawful administrative action to eliminate processing time and requirements.

Question: How many does the Bureau expect to receive in fiscal year 1980? How many in fiscal year 1981?

Answer: From January 4, 1980 to April 18, 1980, we received 2,046 applications for experimental permits and 56 applications for commercial permits. We have issued permits to 2140 experimental applicants and 10 commercial plants. We expect the number of applications to increase dramatically with the effective date of the new law, July 1, 1980. By the end of Fiscal Year 1980 there will be approximately 200 significant new plants on line or under construction. These plants will be supplemented by at least 2,000 smaller plants producing alcohol fuel for on-premises use or for small groups and co-operatives. In Fiscal Year 1981, if present interest continues, we can expect to have an additional 2,000 small plants and an additional 100 medium and large plants.

Question: Please explain how the Bureau plans to streamline the application process in order to process the greatly expanding workload in this area.

Answer: We have greatly reduced the number of forms required for an applicant. We have replaced several long documents containing numerous entries with a single sheet with 14 items. For small plants (those producing and receiving not more than 10,000 proof gallons per year) there will be no routine field inspection.

Medium plants (producing and receiving more than 10,000 but not more than 500,000 proof gallons per year) will file additional documents supporting the single form, such as copies of the corporate charter and application inspections will be necessary to verify the information in the application. The requirements for conducting an application inspection for the medium plant will be greatly reduced from present commercial plant field inspection requirements.

The application for the large plants (those producing in excess of 500,000 proof gallons per year) will be somewhat more detailed than the medium plant but still reduced from present requirements. We anticipate far fewer large plant applications will be filed.

We anticipate that a complete application for a small plant will be processed and the permit issued in much less than 30 days from the receipt of a complete application. Medium plants will be processed within 30 days and large plants within 45 days. The application inspection will be primarily an educational tool to inform the applicant of the requirements of law with respect to his proposed operations.

Question: Will the relaxation of licensing requirements to support gasohol require legislative change?

Answer: The necessary legislative changes have been made in the Crude Oil Windfall Profit Tax Act of 1980 (Public Law 96-223). There are two other areas where we would like to see some changes, but these are not critical to the relaxation of permit requirements.

(1) Section 6103 of Title 26 U.S.C., prevents ATF from disclosing the names and addresses of alcohol fuel producers to State agencies other than tax agencies. In many cases this has been counter productive and perhaps dangerous. A permit has been issued to an apartment address in New York City. We are prohibited from disclosing this permittee's name and address to appropriate fire agencies, though we feel some danger exists. We are likewise prohibited from cooperating with State energy departments, attorneys general, departments of commerce, or any other agency not having a tax administration authority. We will draft a proposal to authorize disclosure to additional agencies.

(2) There is a tax on stills and still manufacturers which is a nuisance and hindrance to alcohol fuel producers. This tax produced less than $16,000 in fiscal years 1977 and 1978. We will draft a proposal to repeal this tax.

Question: Will such a relaxation make it easier to divert alcohol to the illicit market?

Answer: Yes, the liberalized policy will make it easier to divert alcohol to the illicit market. In the past, ATF stationed officers at every distilled spirits plant. We are now phasing out these inspectors and will replace this on-site supervision with periodic inspections. However, we feel that we can detect any significant diversion to the beverage market. We are committed to enforcing the law and violations will not be tolerated. Persons who divert alcohol produced under the liberalized requirements will be vigorously ivestigated.

We feel the potential benefits from enhanced fuel production far outweighs the potential risks. We are willing to be liberal with a responsible, law-abiding industry. Yet, we also recognize that we may have to strengthen the requirements if diversion becomes a significant problem.

FIREARMS

Question: I understand that ATF is cooperating very closely with DEA in an effort to use the firearms laws to apprehend and prosecute drug traffickers. Does this represent the current priority within the ATF law enforcement firearms efforts?

Answer: As a part of our national investigative strategy, ATF Class I priority investigations include the investigation of those individuals, identified by the Drug Enforcement Administration (DEA) as Class I narcotics traffickers, who are vulnerable to prosecution for violations within ATF jurisdiction.

This project has only recently been initiated but to date 3005 DEA Class I narcotics violators residing in the United States have been identified. ATF agents are currently researching their backgrounds and current activities to determine their vulnerability to prosecution for violations within our jurisdiction.

Question: How effective has this effort been to date?

Answer: Approximately 94 criminal investigations have been initiated by ATF regarding these Class I violators. In addition, many lower echelon narcotics traffickers and their associates have become the subjects of ATF investigations as a result of this new approach. Our Chicago and Miami offices are currently involved in major joint investigations with DEA and the United States Attorney in Charleston, West Virginia, has recently initiated a multi-agency task force investigation of major drug traffickers in that area.

Question: The Committee has been told that ATF is interested in computerizing some new firearms tracking systems but has not been able to arrange processing on available computers.

Would you briefly summarize the firearms tracking system, the advantages of having it automated, and an estimate of the costs of the project?

Answer: The Firearms Tracking System is construed as incorporating information available to ATF regarding crime guns currently being stored in at least three different automated data systems. One of these 3 systems is the National Crime Information Center (NCIC), which stores information on only some serially numbered firearms reported to any police agency in the United States as lost or stolen. The second is the ATF National Firearms Tracing Center, which stores information on guns traced by ATF, for ATF and for other police agencies throughout the world. The third system is the Firearms Data Base primarily contained in the TECS system, which includes information on abandoned, located, retained, seized, and undercover-purchase guns, and guns under investigation by ATF.

The preliminary statement of the user's requirements of the Office of Criminal Enforcement with regard to development of an automated Firearms Traffic Analysis System (FTAS) has only recently been completed (April 3, 1980). An estimate of implementation costs will be available only when a final systems design, capable of meeting the following requirements, has been formulated.

(1) Assist ATF in effectively distributing its strategic resources.

(2) Allow ATF to support State and local firearms program objectives.

(3) Allow ATF to publish the results of analyses on the sources of crime guns and their movement in the United States.

(4) Establish ATF as the central source of crime gun data in the country.

(5) Allow ATF to determine the relationships of firearms and crime.

Question: Please describe briefly the difficulties you have encountered in attempts to arrange computer time for the system.

Answer: ATF is not aware of any difficulties in arranging for computer time. ATF currently has under study the design and development of a Firearms Traffic Analysis System and we are just now determining our requirements.

ADP hardware and software requirements for developing the Firearms Traffic Analysis System will be identified.

Any additional ADP hardware that may be needed will be acquired at that time. In addition, software will be developed and tested prior to a final program review which is scheduled for late October 1980. The completed Firearms Traffic Analysis System should be ready for operation by December 1980.

Question: What are your future plans for automated data processing? Are there major systems, in addition to firearms tracking, which you are considering automating?

Answer: Future plans in general call for additional capability in terms of equipment and access to other Treasury computers which will provide the Bureau with some degree of independence in its data processing endeavors. Currently, ATF relies entirely for computer support on other Treasury agencies. We must make certain that these agencies have sufficient capacity in terms of computer software/hardware to provide the level of support needed for ATF to properly administer its mission.

Plans are underway for development of a comprehensive management information system for the Bureau which will measure and monitor resource utilization and productivity in the major ATF support programs of Alcohol, Tobacco, Firearms and Explosives. This system will account for both Regulatory compliance and Criminal Enforcement efforts.

Additionally, work is in progress to identify the specifics required to automate the enormous National Firearms Registry (approximately 250,000 entities). This system, when developed, will enable rapid retrieval of information relevant to these weapons in a secure, efficient manner and permit the current manually updated records to be retired to an off site storage facility.

Question: Both the Regulatory and Law Enforcement program for Firearms show decreases. Why?

Answer: Decreases in our Law Enforcement firearms statistics are the result of a change in ATF's investigative priorities which was implemented in 1978 by directing our resources toward those criminal activities which were intrinsically Federal in nature. In 1978, our emphasis in the firearms field was directed toward multiple defendant, multijurisdictional investigations. This emphasis resulted in a drastic reduction in the number of investigations although our prosecution rate went from 82.1% to 92.4% between FY1978 and the first six months of FY1979.

In the Regulatory Enforcement firearms program, a decrease of eight inspector positions in shown in FY1981 as a result of reprogramming some of our limited resources to the alcohol revenue protection inspection program. This deemed mandatory as a result of our decision in FY1980 to apply more resources to this program, which for a number of years had suffered as a result of our emphasis upon the firearms program. With our severely limited field inspector resources, when one program is emphasized another one by necessity must suffer. To illustrate, in September of 1977 we were authorized 790 inspector positions which had decreased to 647 inspector positions by March 1980. This loss of 143 positions occurred at a time when new programs, such as alcohol-fuels, required additional field resources.

Question: Does the Bureau expect the workload requirements of these programs to continue to decrease? Why?

Answer: In the Law Enforcement area, we have recently reevaluated the program and devised what I believe to be a comprehensive approach to combating firearms crime. The ATF Firearms Enforcement Strategy is designed to impact on firearms crime by interdicting the sources of crime guns while also pursuing criminals whose activities impact on the community at large and who use or possess firearms in violation of the Gun Control Act. We have specifically directed our agents to pursue investigations of DEA Class I violators, prominant organized crime figures, and members of terrorist/hate groups who violate the Federal firearms and explosives laws in their criminal activities. Because of this change, I fully anticipate that our firearms program will show substantial increases in FY1981 for Criminal Enforcement.

In the Regulatory Enforcement area, we do not expect the workload requirements for these programs to decrease. As stated in the prior part of this question, the decreased staffyears assigned to the firearms program was necessitated by our limited field inspection resources, and the increased emphasis that we have placed upon some of our other field programs, particulary the alcohol revenue protection program. The actual workload requirement for the firearms program has, if anything, increased over the years. To offset the decreased resources applied to the firearms program, we are conducting a more selective compliance inspection program. We are also supplying the new licensee with a wealth of educational material at the time of license issuance. This reference material consists of: Federal regulations pertaining to the type of licensed operation; questions and answers common to the type of licensed activity; illustrative guidelines regarding preparation of records for the various type of transactions common to the operation; and providing a requisition form for obtaining additional forms necessary for the licensed operation. Although this handout material does not take the place of an on-site inspection, with our very limited field inspector resources and the vast number of firearms licenssees, approximately 170,000, we have had no other choice. However, through improved selectivity of licensees for inspection and the use of this educational material at the time of license issuance, we do expect that the limited field resources presently applied to the firearms program will be adequate. To further improve the use of our limited field resources, we will shortly be initiating firearms siminars in areas of the country where there is a large concentration of licensees. Through the use of these siminars, we hope to overcome many of the problems that result from the lack of our personal inspection contact with the licensee.

Therefore, in both the law and regulatory firearms programs, increased workloads can be expected, especially from the regulatory program in FY 1982.

CRITERIA FOR TARGETING ATF INVESTIGATIVE RESOURCES

Question: Last year (p. 263 of FY 1980 hearings) the Committee was told about the ATF effort to develop investigative standards and guidelines which would channel ATF resources to those cases where successful prosecution was most likely.

Has the ATF Criminal Enforcement effort to devise investigative standards and guidelines for white-collar and organized crime been completed?

If so, please supply a copy of the standards and guidelines for the record. If not, when will they be completed?

Answer: Yes, ATF Order 3210.7A, (copy at end of questions) titled Investigative Priorities, Procedures, and Techniques was completed on December 14, 1979. In addition, we are presently working with the FBI, DEA, IRS, and the Department of Justice to further identify those individuals involved in white-collar and organized crime who may be in violation of the statutes for which ATF is responsible.

ATF implemented a system of priorities for investigations within Criminal Enforcement effective January 1980. These priorities comprise the centerpiece of ATF's national enforcement strategy. Considerations in the development of the priorities included public safety, organized and white-collar criminal activity, interjurisdictional availability of instruments of violence and the constraints of State and local resources and jurisdictional boundaries. ATF's priorities were designed to parallel and insure effective use of the limited resources available, particulary in combating organized and white-collar criminal activity. Field offices follow these priorities, concentrating on the violations of highest priority.

In conjunction with the establishment of priorities, ATF is also implementing a computerized priority tracking system to provide management with continuing updates on manpower utilization in terms of the Bureau's priorities.

The individual priority rankings range in order between 1 and 53, with 1 being the highest priority. In addition, the individual priority rankings are grouped into three classes of priorities. Class I priorities (1 through 21) includes bombings and arsons involving death or injuries and/or involvement of organized or white-collar crime. It also includes all other significant violations of Federal statutes within ATF's jurisdiction, involving organized or white-collar criminal activity and in certain instances, the crimes of perjury, attempted bribery and/or jury tampering.

Class II and III priorities involve violations of statutes enforced by ATF that do not involve organised or white-collar crime in decending order of priority.

CHAPTER A. INVESTIGATIVE GUIDELINES AND PRIORITIES

1. BACKGROUND AND INVESTIGATIVE GUIDELINES.

a. During 1978, the Bureau instituted a national investigative strategy which directed investigative emphasis toward problems of special Federal interest. Considerations in the development of the strategy included public safety, organized and white-collar criminal activity, interjurisdictional availability of instruments of violence, and the constraints of State and local resources and jurisdictional bounderies. To further refine this strategy and to ensure that Bureau priorities parallel the prosecution guidelines of the Department of Justice, the priorities have been redefined combining all areas of enforcement responsibility, providing guidelines and criteria for the types of investigations to be conducted, and reflecting the qualitative and quantitative aspects of the expenditure of resources within the enforcement program.

b. Enforcement programs will be administered uniformly, applying the same standard of impartiality to all violations investigated. It is not inconsistent with this principle to select the more aggravated cases, or those having the most deterrent effect, since available resources preclude investigation of all infractions of the law. Selectivity will be guided by the priorities as stated in this chapter.

c. Bureau personnel will not conduct any investigation outside of Bureau jurisdiction without prior approval of the ADCE.

d. Assistance to State and local authorities is a major responsibility of the Bureau. Within our resources, capabilities and jurisdiction, every effort will be made to assist these agencies when requested; however, violations of Federal interest will continue to be the paramount factor. Where circumstances dictate, investigations may be conducted jointly with State or local jurisdictions. Cases developed may be referred to State prosecutors for court action.

e. Intelligence and information obtained will be properly evaluated and referred to proper jurisdictional authority, as appropriate.

2. INVESTIGATIVE PRIORITIES. Exhibit 1, List of Investigative Priorities, delineates priorities by overall numerical ranking and rank within one of three broad classes, as defined below.

a. Class I includes bombings and arsons involving death or injuries and/or involvement of organized or white-collar criminal activities. Class I also includes all other significant violations involving organized or white-collar criminal activities and in certain instances the crimes of perjury, jury tampering and/or attempted bribery (see ATF O 8600.1A, Integrity and Other Investigations).

(1) Organized criminal activity pertains to individuals associated with criminal groups whose illegal activities are pursued on a recurring basis; these illegal activities are not limited to any one type of crime and include white-collar crimes and political corruption.

(2) Class I violations also include those committed by individuals who align themselves with groups or organizations that advocate the deprivation of the rights of others through the use of firearms and/or explosives, or that use firearms or explosives criminally, to significantly impact on the public welfare.

(3) Individuals identified in Department of Justice strike force lists or by State crime units, as major criminals, and those identified by the Drug Enforcement Administration (DEA) as class I narcotics traffickers, who are vulnerable to prosecution for violations within ATF jurisdiction.

b. Class II covers all other bombings and arsons not involving death, injury, and/or organized or white-collar criminal involvement, but multijurisdictional constraints or lack of jurisdictional authority by State and local agencies dictate Federal intervention. Class II also includes the other most serious violations in the fields of explosives, firearms, cigarette smuggling, and alcohol. Organized crime involvement is required only for illicit liquor violations.

c. Class III encompasses crimes of lesser gravity which are prohibited by Federal statute and may or may not be prohibited by parallel State statutes but which must be addressed by Federal authority in exigent circumstances, or by statutory requirement.

d. The priority of certain investigations can only be determined on a case-by-case basis; resources will be channeled into areas where the public safety is endangered, including assaults upon Bureau personnel and witnesses, bribery, perjury and subornation of perjury. The FBI will investigate attempts to influence members of grand juries, threats or assaults against Federal judges and jurors. Assaults on Bureau personnel are coordinated with the Justice Department by the Office of Internal Affairs, except for assaults on non-1811 employees which are investigated by Criminal Enforcement (see ATF O 3000.1B).

EXPLOSIVES TAGGING RESEARCH

Question: A year ago the Senate Governmental Affairs Committe asked the Office of Technology Assessment (OTA) to analyze proposals for Explosives Tagging Programs to determine if tagged explosives would be safe, whether the cost of the program to both government and industry would be prohibitive, and whether the program would be useful to law enforcement agencies. The OTA study will be cpmpleted in a few days and the committee has been informed by OTA that there are safety hazards which may take several additional years of research to completely resolve.

I also understand that OTA reports negatively on the competency of the research performed by the Aerospace Corporation on this project to date. Specifically, the committee has been informed by OTA that Aerospace has not kept complete records of their research and they do not have adequate testing criteria. Mr. Dickerson, are you satisfied with the quality of work performed by The Aerospace Corporations?

Answer: Yes. The Aerospace Corporation is eminently qualified to act as technical manager of the Explosives Tagging Program. Aerospace provides the Bureau of Alcohol, Tobacco and Firearms with an objective systems engineering organization that is capable of analyzing, evaluating, and assessing complex systems and of formulating criteria and plans for scientific and technical programs. Aerospace is qualified to provide objective technical support by virtue of not only its lack of any conflict of interest, but also because of its diverse technical capabilities. These capabilities include a multidisciplined professional staff of more than 1,750 scientists and engineers and an extensive amount of equipment available to ATF which could not be matched without large expenditures or without impacting program schedules. The Aerospace expertise and capabilities are especially valuable to ATF because of the diverse range of engineering and scientific disciplines necessary to conduct the Explosives Tagging Program.

Question: I understand that the explosives industry and the NRA continue to oppose the program because they believe it will be too costly, unsafe, and won't work well as a law enforcement program. On the other hand, OTA has concluded that the program, once proven safe, would be a useful law enforcement technique.

Mr. Dickerson, what is your reaction to the continuing industry criticism?

Answer: The continuing criticism of explosives tagging from the explosives industry has now extended to a lack of cooperation with ATF in the research program. We understand the concerns of the industry with respect to safety, cost, and utility of the program. These are also ATF concerns. The most important factor in our development of an acceptable tagging program is safety, and no single area of research has occupied more of our concern or resources. Please understand that ATF will not permit the tagging of an explosives material until every aspect of its safety has been proved. We are also refining the taggant technologies to make the program more effective and less costly, and we will continue to make every effort to work with the industry to keep costs at an acceptable level. While tagging is not a panacea, the ability to trace explosives will provide law enforcement with a useful tool against criminal bombers. I personally meet with representatives of the explosives and ammunition industries to discuss the industry point of view and promote cooperation and understanding.

Question: Why is the Bureau proposing to reduce explosives tagging research by $932,000 in Fiscal Year 1981 to a funded level of $800,000?

Answer: The funding for FY-1981 of $800,000 was reached after much discussion and review. Although explosives tagging research and development efforts could be achieved sooner and more easily with additional funding, we are sensitive to the recent strong national desire to reduce government spending at all levels. With limited funds we felt we would concentrate on the advanced research and development of identification tagging. Detection tagging would be allocated as much as possible but only after the allocations for identification tagging are made. While seriously curtailing our research, the reduction in funding will permit us to continue moving forward with the program and also respect the public's concern over inflation.

ELIMINATION OF ON-SITE INSPECTION OF DISTILLERY OPERATIONS

Question: The Distilled Spirits Tax Revision Act of 1979 (P.L. 96-39, July 26, 1979) removes the statutory requirements for a closed distillation system and on-premises inspectors and instituted the all-in-bond method of determining taxes on distilled spirits, the Secretary of the Treasury has discretionary authority to determine the amount of supervision needed to protect the Federal excise revenues at distilled spirits plants.

The justification material (ATF-6) indicates that the Bureau will make a transition from the current system of on-site inspection of distillery operations to an audit program. Last year we were told that $6.5 million and 200 positions were associated with the on-premise inspection program and that substantial savings would result if the bureau changed to an audit program. Why will it take until Fiscal Year 1984 to make the complete transition?

Answer: Initiation and implementation of such complex changes to a major government revenue program, within the limited resources available to a bureau our size, represents a significant responsibility; one that we are determined to accomplish without imposing an unwarrented burden to an industry unprepared to assume it and without a significant increase in risk of revenue loss.

Our planning for implementation is under constant and critical internal review to ensure timely changes in direction will be made as needs are identified to ensure a smooth transition from joint custody to the all-in-bond system.

Probably the most important point to be made at this time is that there is a critical distinction to be made between the concept of changes in the taxing procedures and the conversion from joint custody to the all-in-bond concept. While changes in taxing procedures may be implemented on a specific date, joint custody can not be eliminated until all necessary steps have been accomplished by both ATF and each industry member, on an individual basis. To eliminate joint custody in other than a deliberate, progressive, planned sequence may result in jeopardy to the protection of the revenue.

It is our opinion that removal of distilled spirits plants from joint custody, should be on an individual plant basis, as each plant is determined to be eligible to be removed. Emphasis must be placed on ensuring the integrity of revenue protection rather than on a desire for quick manpower savings through premature abolishment of supervision.

Supervision should remain in effect until each plant has a certified, and agreed to, actual inventory reconciled to the book inventory. Additionally, each plant's internal controls must be certified as being adequate prior to having supervision removed.

We feel that no Government locks or seals should be removed at any plant until that plant's inventory and controls have been certified. The practical extension of this position is that the level of supervision currently provided for each plant would remain essentially the same until the certification process for that plant is completed. After certification, the level of supervision can be eliminated or reduced depending upon other considerations, on a plant by plant basis.

Our current planning is for phase out periods divided into four broad categories.

(1) DSP's with production only, warehousing only, production and warehousing only, regardless of the amount of tax paid and all industrial DSP's. There are 62 plants in the category.

(2) DSP's (other than industrial) that pay less than $1,000,000 in distilled spirits tax annually. There are 38 plants in this category.

(3) DSP's (other than industrial) that pay at least $1,000,000 but less than $13,000,000 in distilled spirits tax annually. There are 52 plants in this category.

(4) DSP's (other than industrial) that pay $13,000,000 or more in distilled spirits tax annually. There are 49 plants in this category.

In addition, there are 17 plants where Customs has informed us they will have difficulty in servicing under the immediate delivery procedure and where we will continue our activity until Customs can provide such service.

The 214 DSP's (other than alcohol for fuel use and plants presently operating under pilot procedures) currently in existance have been assigned to one of these categories and certifications have been scheduled taking into consideration our staffing resources.

We have developed a plan for performing certification audits at each of the 214 plants, and are currently underway, with one nearly complete and 17 in process on April 25, 1980. These certifications are thorough, but unfortunately time consuming, which is why we earlier forecast 1984 as completion date. They also require the use of both inspectors and regulatory auditors, and the latter are in rather short supply because of current restrictions on hiring.

Question: $577,000 and 38 positions savings are shown associated with this transition in fiscal year 1981. Would it be possible to double or triple this savings rate by requiring a more timely transition? If not, why not?

Answer: In fiscal year 1979 the Bureau was authorized 200 average positions. In anticipation of approval of the All-in-Bond method of determining taxes, the number of positions authorized was reduced to 192 for fiscal year 1980. However, for fiscal year 1979 only 166 average positions were actually used for distilled spirits plant supervision. For fiscal year 1981 we plan a further reduction of 64 average positions, leaving 128 inspector average positions for plant supervision. Although the $577,000 and 38 positions are savings relative to reduced distilled spirits plant supervision, the funds and positions have been reprogrammed to Revenue Protection to initially provide resources for our regulatory audit capability. The remaining 26 positions of the 64 reduction are absolute reductions. Accordingly, from fiscal year 1979 to fiscal year 1981 the reduction is from 200 to 128 average positions. This is considered to be the most timely transition from distilled spirits plant supervision to the All-in-Bond method. An accelerated transition could possibly result in jeopardy to the protection of the revenue and unduly burden the industry members.

Question: What progress has been made in withdrawing on-premise inspectors from distilleries since the distilled spirits tax revision act was passed?

Answer: This is a difficult question to answer with regard to cause and effect (the cause being passage of the act and the effect being withdrawal of on-premise inspectors). The Distilled Spirits Tax Revision Act was signed by the President on July 26, 1979, but had an effective date of January 1, 1980. By the time the bill was passed, the FY1980 budget had already been established with 192 staff years allocated to supervision of distilled spirits plants. Additionally, the law did not become effective until the second quarter of this fiscal year. Even so, our statistics show that on an annual basis we will be expending approximately 146 staffyears during FY 1980 on distilled spirits plant supervision; 46 staff years less than originally budgeted for this program. This redirection represents both the generalized redirection of inspector resources away from distilled spirits plants in anticipation of elimination of joint custody, as well as the intended removal of on-premises supervision as plants are certified for this action. (As of March 31, 1980, no on-premises inspectors had been withdrawn from distilleries solely as a result of the passage of the act.)

Question: How many staff years will be spent physically supervising distilling operations in Fiscal Year 1980 and 1981?

Answer: In FY 1980, the budget allocates 192 staff years, and the FY 81 budget allocates 128 staff years to the supervision of distillery operations. However, as noted in our answer to your previous question, we now anticipate expending approximately 146 staff years on this program in FY1980. Because of the many variables, it is difficult to say at this time whether we can expect similar savings from the FY1981.

Question: What criteria is being used to determine the degree of supervision needed at each plant?

Answer: Ultimately, the Regional Regulatory Administrator may require the degree of supervision that he feels is necessary to protect the revenue and ensure compliance with provisions of the Internal Revenue Code. However, the Regional Regulatory Administrator will be guided by certain criteria as follows:

(1) Audit certification and evaluation process. ATF will analyze internal controls and inventory accountability as an initial step in determining the degree of supervision needed at each plant. Regulatory Enforcement auditors will make a recommendation to the Regional Regulatory Administrator as to the adequacy of the proprietor's internal controls and inventory accounting.

(2) Statement of Security. Each proprietor is required to submit this statement to the Regional Regulatory Administrator outlining the physcial security measures to be taken by the proprietor to ensure protection of the revenue.

(3) Compliance History of the Plant. The Regional Regulatory Administrator has data available to him showing the past compliance of each plant with laws and regulations.

(4) Size and Complexity of the Plant. The amount of revenue generated by each plant is also a factor in determining the degree of supervision needed to protect that revenue.

Question: What have been the major obstacles to eliminating on-premise inspection at more plants?

Answer: There have been no major obstacles to the elimination of on premises supervision at distilled spirits plants. There are, however, self-imposed precautions which we have implemented so as to ensure a minimum risk to the revenue.

Prior to removing our personnel from any distilled spirits plant we want to certify the adequacy of each plant's internal controls and each plant's inventory accountability. We will also be checking the security arrangements which the plant will maintain when government security is no longer provided.

We intend to carry out these certifications and security checks in a smooth, orderly and thorough fashion.

Question: What measurable savings have occurred or will occur from eliminating on-premise inspectors?

Answer: As explained earlier, no savings have yet occurred due specifically to the elimination of joint custody requirements. When the transition to joint custody is completed, it is anticipated that 200 on-premises inspector positions will have been eliminated. However, our studies indicate that 90-95 auditor positions will be needed to perform Revenue Protection post-audits at distilled spirits plants to give a degree of protection to revenue equal to that under the old system. In addition, as we are able to accomplish the withdrawal of inspectors from distilled spirits plant supervision, we will have some need to redirect inspector resources to other activities.

Question: Can the All-in-Bond method of determining alcohol excise tax be instituted at distilleries where on-premise supervision is still required? If not, does this result in any inequities in the way distilled spirits plants can operate?

Answer: Yes, the All-in-Bond method of determining alcohol excise taxes was instituted at all distilled spirits plants on January 1, 1980; and is independent of any need for requiring on-premise supervision.

Question: Are any distilled spirits plants operating under the All-in-Bond system now?

Answer: Every distilled spirits plant in the United States has been operating under the All-in-Bond system since January 1, 1980. The elimination of supervision as explained earlier, is independent of this process and is also more complex. In order to assure protection of the revenue, while entirely assuring a smooth transition, the complete elimination of supervision will take more time to accomplish.

Question: When do you expect the All-in-Bond system to be fully implemented?

Answer: Current plans are for full implementation to be accomplished by the end of FY 1983. However, the program is under continual review and it is possible experience may indicate that the procedure can be hastened. On the other hand, although this is a program of high importance, any significant curtailment of our resources could lengthen that time span.

VIOLATION RATES IN REGULATORY ENFORCEMENT PROGRAMS

Question: Last year's justification material displayed the violation rate in the Regulatory Enforcement program. Please provide the committee with a table which shows the violation rates for each of the enforcement programs for fiscal years 1977, 1978, 1979, and projected for 1980 and discuss the trends.

Answer: The following table shows the violation rates from each of the enforcement programs for fiscal years 1977, 1978, 1979, and is projected for 1980.

Violation Rates
Regulatory Enforcement Programs

	1977	1978	1979	1980*
Alcohol	23.3%	18.3%	23.0%	20.8%**
Tobacco	18.3%	14.0%	14.3%	13.8%
Firearms	34.0%	32.6%	28.2%	24.4%
Explosives	34.4%	34.0%	24.4%	21.8%

* Projected based on first five months of FY 1980.
** Experimental Gasohol plants excluded.

Alcohol

The violation rate in the alcohol program appears to fluxuate from year to year partly due to changing emphasis on certain programs. The violation rate at distilled spirits plants should increase as our inspectors are withdrawn from the premises over the next few years due to implementation of all-in-bond. Inspectors assigned to plants now conduct several unscheduled inspections (limited in scope and purpose) while they are required to be present for other duties. As the plants are certified, the inspectors removed, and indepth audits replace the unscheduled inspections (in part), the violation rate is expected to increase.

Tobacco

While the violation rate has fallen 4.5% from 1977, it remained relatively stable during 1978, and is projected to remain stable through FY 1980. The slight decrease reflects the increased level of voluntary compliance within the industry.

Firearms

The violation rate for the firearms program declined during the three year period from FY 1977 - FY 1979, and shows a further decline for FY1980, based on our projection covering the first five months. We attribute this declining violation rate to two primary factors. Commencing in FY 1978 we concentrated our inspection activity on large manufacturers, importers, and licensees who dealt in large quantities of firearms, or on those types of licensees who manufactured, imported or dealt in destructive devices or ammunition for destructive devices. Historically, these types of licensees have enjoyed a low violation rate under the GCA of 1968. However, due to the volume, or type of firearms handled by these types of licensees, we feel that it is essential that we conduct repeated inspections on them to preclude potentially serious problems from arising if we did not make these preventive type inspections. Errors in these areas would have a significant impact on the tracing of crime guns.

We have in recent years also given the new licensee a wealth of reference material covering the requirements for operation under his type of license. We believe these two factors consisting of the type of licensee we are concentrating our inspection activity on (large volume or destructive device licensee), and the use of educational handout material covering the type of licensed operation are the primary reasons for the declining violation rate.

We do not expect the violation rate to continue to decline indefinitely. Rather, as we refine the methods used to identify licensees who have a high probability of being in violation of the act, then we would expect the violation rate to start increasing. We have been working for some time, on identifying the elements common to licensees who violate the GCA of 1968. As we develop an accurate profile of these licensees for inspection selection purposes, then we would anticipate that the violation rate will increase.

Explosives

There has been a continual declining violation rate for explosives licensees during the four year period from FY1977-FY1980, from a high of 34.4% in FY 77 to a projected 20.8% rate for FY 80 based on the first five months of FY 80 operation. We attribute this declining violation rate to our effective compliance inspection program, which essentially requires an annual compliance inspection on any licensee having storage facilities located where a detonation would be a threat to the welfare of the general public. For any serious violations found during a compliance inspection, we conduct a recall inspection within a maximum six months period to verify that the violations are no longer occuring. Concerning the explosives program, we strongly believe in the old adage that an "ounce of prevention is worth a pound of cure."

PURCHASE OF VEHICLES

Question: ATF has authority to purchase 300 vehicles. How many were purchased in Fiscal Year 1978? In Fiscal Year 1979? How many will be purchased in Fiscal Year 1980?

	Fiscal Year		
	1978	1979	1980
Number of Vehicles Purchased	399	243	125
Mileage Readings:			
Over 60,000 miles	210	187	215
Over 80,000 miles	203	174	198
Over 100,000 miles	119	197	104

Question: How much is requested for the purchase of vehicles in FY1981?

Answer: $2,222,000 is being requested for the purchase of 300 vehicles.

EQUIPMENT PROGRAM

Question: An increase of $915,000 has been requested for the purchase of equipment. What is in the base for the purchase of equipment?

Answer: Our FY1981 equipment request of $5,056,000 consists of an FY1980 base of $4,446,000. The request for an increase in the equipment program of $915,000 has been reduced by $79,000 for Special Investigative Equipment as part of the Administration's further FY1981 budget reduction of $2,100,000 for ATF.

Question: What programs will this equipment be used for?

Answer: This request for Special Investigative Equipment, Radio Communications Equipment and Police Type Vehicles will be used by our special agents in each of our enforcement programs, Alcohol, Tobacco, Firearms and Explosives.

Question: What is the overall state of ATF equipment?

Answer: Presently the Bureau is continuing to upgrade the investigative type of equipment used by our special agents in the field. This is the type of equipment utilized in our investigations on a day-to-day basis and is subject to some wear and tear. The overall equipment inventory is presently somewhat less than adequate and this coupled with the constantly changing state of the art and increasing costs has resulted in our present modest request in this area. As a means to accomplish instantaneous communication, it is necessary to revamp the ATF two-way radio system. This change in system will include intra-district communications as well as inter-district communications. Additional radio frequency channel authorizations will therefore, be required. The present ATF radio network has only two VHF radio frequency channels allocated. The expanded system will require additional channels. There are no VHF radio frequency channels available to ATF for use in the proposed expanded system. This therefore, will require a complete new system of sectors and the purchase of equipment.

In the area of police type vehicles this increase is to fund the purchase of replacement vehicles. This will compensate for the difference between the FY1980 vehicle replacement quota (125) versus the intended number of replacement vehicles in FY1981 (300).

USE OF ATF AGENTS BY THE SECRET SERVICE

Question: ATF Congressional Budget submissions for FY1980 and FY1981 contain no mention of ATF involvement in candidate and nominee protection. The committee understands that ATF is providing personnel to assist the Secret Service with their responsibility to provide Presidental Candidates with security protection.

How many ATF personnel are being used for candidate protection?

Answer: Secret Service initially asked ATF to provide 420 special agents to receive three days training by Secret Service personnel, and thus be available to assist in candidate protection as needed. These 420 agents represent 70 percent of "other Treasury agents" requested to provide assistance to Secret Service during the presidential campaign.

Since September 1979, of the 420 agents who received special training, 243 of them have been assigned extended type details, the vast majority being 21 days in duration. During this period of time, almost all of our agents have, at one time or another been involved in providing assistance on a local basis for short periods of time, as the candidates have traveled throughout the United States.

During the first half of FY1980, ATF has devoted a total of 66,868 manhours in providing assistance to Secret Service.

Question: What impact has this added responsibility had on ATF's efforts to pursue its own programs?

Answer: There is no way to determine the exact impact this loss of personnel has had. By examining the number of man hours our agents have spent on Secret Service details, we can only assume that had we not lost in excess of 32 staff years, our agents would have perfected more criminal cases. In many instances, some of our district offices, at a given time, were required to assign almost all of their agents to Secret Service details. ATF will continue to provide assistance for the remainder of FY1980 and into FY1981.

QUESTIONS SUBMITTED BY SENATOR BAYH

Question: Under P.L. 96-223, ATF was given authority to issue new regulations to govern the operations of alcohol fuel plants. The draft version of the alcohol fuel plant operating permit application form (ATF 5110) is clear and brief, being only two pages long. However, on page two of the form, it states that "applications for medium and large scale plants must attach additional information required in the instructions." With this "additional information" requirement, will medium and large scale plant applications actually provide ATF any less information than was required before P.L. 96-223 became law?

Answer: Medium and large plant applications information will be substantially reduced from requirements prior to the effective date of P.L. 96-223.

Question: What is the estimated cost to the applicant of preparing the additional information?

Answer: Estimated costs are minimal. Generally, these documents are available for other business reasons and the applicant may furnish ATF with photocopies. For example, applicants for large plants must support their application with copies of corporate documents, such as the corporate charter.

Question: The instructions to the draft version of form ATF 5110 indicate that the ATF regional regulatory administrator has total discretion to require "any other information" that he chooses. Examples of "any other information" may include (but are not limited to) sources of funds to be invested, names and addresses of stockholders. Why does ATF gives its regional offices discretion to require this additional information of some applicants, and not others?

Answer: ATF gives discretion to the regional offices to require additional information of some applicants, and not others, because the regional offices are responsible for determining the eligibility of the applicant. The regional offices are the highest practical level able to make informed judgments concerning local conditions. In general, any person would be ineligible to hold a permit if the applicant--

(1) has not in good faith complied with the provisions of law and regulations; or
(2) is likely to violation the conditions of the permit; or
(3) makes any false statement as to any material fact in his application; or
(4) has violated or conspired to violate any law of the United States relating to any intoxicating liquor, or has been convicted of any offense under Title 26 punishable as a felony:

The regional office must be able to evaluate an application using information sufficient to determine the eligibility of the person making the application.

The additional information is required to verify that the person making the application is actually the person responsible for the operations. If a plant incurs a tax liability, ATF must be able take action against the person who incurs the liability.

Additional information is also required by other Federal statutes. The Clean Water Act requires that ATF must obtain certain specific information with respect to the environmental impact of the plant. The regional office must require additional data in order to make informed decisions with respect to eligibility under the EPA statutes. While we can make reasonable judgments in this regard for the small plants, we are not able to make these decisions for other plants on the basis of the minimal information contained in the application. The need for the information may depend on such factors as the location of the facility. The National Historical Preservation Act is another example of such Federal statutes.

The regional office may also require additional information to clarify or verify an item on the application form. For instance, a one-word response "tanks" might be insufficient to describe security measures in item 11 of the proposed form.

Question: What criteria will the regional offices use to determine which applicants need to provide ATF with this additional information?

Answer: Additional information required is based on the fact that the data is necessary to determine whether the permit may be lawfully issued and maintained. Without this information, ATF would be compelled to deny the application in order to fulfill our statutory charter. Our policy is to require only that information which is needed to meet the requirements of law.

Question: Why is this additional information necessary?

Answer: As stated in response to why additional information is required of some applicants and not others, the additional information may be necessary to determine actual ownership, eligibility and compliance with other Federal statutes.

Question: Are not the ATF denaturant requirements sufficient to protect against alcohol being used as a beverage, thereby eliminating the need for bonding requirements for all alcohol fuel plants?

Answer: No. Not all alcohol produced is rendered unfit for beverage use denatured at the time of production. Title 26, Section 5001, establishes the tax liability at the time of production An alcohol fuel producer who uses undenatured alcohol on his premises or who transfers alcohol to other plants must provide the Government some protection for the potential tax liability he has incurred. We are not requiring that all alcohol be rendered unfit for beverage use. Only alcohol removed from the premises as a fuel must be rendered unfit. Denaturation may not be part of the production process but may be accomplished at some later stage. For example, large quantities of undenatured alcohol are being imported from South America for denaturation in this country. Until it is denatured, it is fit for beverage purposes. Therefore, large quantities of alcohol would remain suitable for beverage use and liable to be taxed if diverted to the beverage market.

Question: Is not a bond requirement a barrier to operation of alcohol fuel plants except in cases of small plants (which have no bond requirement) and plants operated by large companies which are not hindered by the cash requirements necessitated by a bond?

Answer: We do not feel the bond requirement is a barrier for medium plants. The bonds we propose are 80% less than the bonds presently required from comparable beverage and industrial plants. The companies which write these bonds, charge annual premiums ranging from $10 to $20 per $1,000 of coverage. The minimum bond for a medium plant will be $1,500 and the maximum $50,000. Annual premiums would then range from $15 to $1,000, depending on annual volume of operations and the surety company involved. The cost per gallon for the bond is from 1/10¢ to 2/10¢.

Question: How long does ATF estimate it will take to process a properly completed application for medium or large plant under P.L. 96-223?

Answer: We estimate that a medium producer's application will take 30 days to process from the receipt of a complete application. A large producer's completed application should be processed in about 45 days.

Question: How many work-years will ATF provide in FY 1980 to alcohol fuels related work, and how many work-years will be allocated to alcohol fuels in FY 1981?

Answer: Through February 1980, 6.8 inspector work-years have been utilized on all alcohol fuels related work. This included participation in 89 seminars requested by members of Congress, State legislators, colleges and universities, as well as numerous farm and civic groups. We estimate 16.3 work-years will be provided for alcohol fuels related work during FY 1980.

Although new categories established by the Windfall Profits Act make it difficult to project the work years needed for FY 1981, 30 work-years will be required to meet the increased demands resulting from applications to establish distilleries. The Bureau has only been able to meet its responsibilities in the area of alcohol fuels by diverting resources from other programs. To continue with similar redirections in FY 1981 will result in further reductions in other vital programs such as FAA consumer and revenue protection.

Question: How soon do you expect implementation of the Alcohol Fuels Regulatory Simplification Act which was passed as part of the Windfall Profits Tax bill?

Answer: The Act will be implemented July 1, 1980, pursuant to the effective date of the statute. Certain administrative actions have already been taken. For instance, bonds for plants intending to qualify under the new law are being calculated under the anticipated requirements.

Question: Public Law 96-223 requires the Secretary of the Treasury to report to Congress on what methods may be used to limit the importation of alcohol for use as a fuel. When will this report be completed? Will it be available prior to the October 2, 1980 deadline included in P.L. 96-223?

Answer: Since this provision of Public Law 96-223 addresses areas which are outside the scope of ATF responsibilities, I cannot respond to your question as to when the report will be completed. However, with respect to the requirement to conduct surveillance of alcohol imports and to monitor their effect on the domestic (on the domestic fuel alcohol industry), ATF will be able to provide raw data for making these determinations. This will include the numbers of alcohol fuel plants, and the quantities of spirits produced and used for fuel. In addition, ATF is currently modifying the reporting requirements for existing denaturing plants to obtain more data on fuel use of distilled spirits.

Question: Under P.L. 96-223, the Secretary of the Treasury is given authority to issue new regulations to govern the operations of alcohol fuel plants. This authority becomes effective July 1, 1980. When are both proposed regulations and final regulations expected to be issued under this new authority?

Answer: ATF will issue temporary regulations to implement Public Law 96-223. These regulations will be published June 6, 1980 and effective July 1, 1980. Taking this approach allows the public to take advantage of the new law's provisions immediately upon their becoming effective.

The temporary regulations also serve as proposals for final rules, subject to a 120 day comment period. Final regulations will not be issued until all comments have been evaluated and if there is sufficient demand, public hearings will be held. Issuance of final regulations is targeted for February 2, 1981.

The draft temporary regulations are currently in the final stages of review within ATF.

Questions Submitted by Senator Laxalt

EXPLOSIVES TAGGING

QUESTION: The recently completed OTA evaluation of the explosives tagging program concludes that terrorists and professional criminals would apparently have sufficient knowledge and resources to counter both the identification and detection tagging program at virtually any level of implementation. Some of the countermeasures they identify could be used by the less professional bombers as well.

In addition, your own statistics show identification tagging would at best be useful in only 45 percent of bombings (1978 figures).

Given that OTA estimates absolute minimum costs for the program at over $45 million per year, can you justify going ahead with a program that will be ineffective against terrorists and criminals; and will not affect a majority of bombings?

ANSWER: We feel justification for continuing the identification tagging program exists. We do not agree that OTA found the program to be either ineffective against terrorists and criminals or ineffective in a majority of bombings.

To the contrary, OTA found that "The law enforcement experts whom OTA consulted predict that many terrorists and other criminals would probably not avail themselves of countermeasures that were theoretically available to them." This OTA finding supports the ATF judgment, based on our experiences with the imprinted date/shift code data, that the identification tagging program will be an effective law enforcement tool.

Further, OTA analyzed the ATF incident statistics and reported that 31% of the identified explosives fillers were packaged, cap-sensitive explosives, 17% were black powder, and 17.5% were smokeless powder. Tagging of these explosives would amount to over 65% of the bombs being tagged, almost two-thirds of the bombs.

QUESTION: The OTA report in several instances makes references to a lack of adequate research, inadequate documentation of research that has been done, and a failure to conduct necessary tests on explosives that you have previously testified were ready to be tagged.

I do not doubt that the Department's testimony on these matters was given in good faith, based on the information the Aerospace Corporation had supplied. However, these testing problems, and certain testimony given directly by Aerospace officials, which was also contradicted by the OTA report, gives rise to some doubts as to Aerospace's performance.

a) Has the Bureau conducted any performance evaluations of Aerospace's work on the tagging program?

b) Prior to the OTA evaluation, had any impartial outside technical body or group or individuals been asked to review Aerospace's work?

c) Do you have any plans to revise your contract with Aerospace, or institute tighter controls over their work?

ANSWER: a) Aerospace's performance on explosives tagging research is under monthly review and evaluation by ATF. This review process involves a monthly report in both written and oral formats. ATF sets specific goals for the specific research tasks each year in the areas of identification, detection and untagged detection research.

With regard to research, documentation, and testing of identification taggants, the OTA statement that ". . . the testing done to date creates a reasonable presumption that the 3M identification taggant is compatible with dynamites, gels, slurries, emulsions, and black powder," is a valid one and sums up the position ATF has taken previously. We further agree with OTA that more research is required on some smokeless powder and at least one cast booster composition as a result of evidence of reactivity with taggants under extreme test conditions.

The detection tagging program is at a very early stage of development. Because of this preliminary nature of the research, there is not, as OTA points out, a great deal of documentation. Much of the data is simply not yet available.

b) An Advisory Committee on Explosives Tagging has been in existence throughout the duration of the explosives tagging research program. This advisory committee, with members from the scientific community, industry, and government, receives regular briefings on Aerospace research and all research task reports prepared by Aerospace. Thus, the advisory committee provides a continual, impartial review of the research being conducted by The Aerospace Corporation.

c) The controls currently being implemented and the contract are appropriate. ATF will continue to perform detailed reviews of the overall activities of Aerospace and its subcontractors on a regular and continuous basis. Each project will continue to be monitored, and all reports will continue to be reviewed. ATF will continue to utilize, on a regular basis, its Advisory Committee on Explosives Tagging in its review of the program. Explosives manufacturers were brought in early in the program to provide essential industry experience, and we will continue to call in experts from both government and industry to review individual projects as needed.

The ATF and Aerospace personnel assigned to this program are highly qualified professionals. Their combined expertise covers explosives, explosives detection, and law enforcement.

QUESTION: The cost of the tagging program, as identified by OTA, seems to be considerably higher to the explosives users than your testimony had previously indicated. BATF has testified to price increases in the neighborhood of 2 percent for powders and 4 percent for high explosives, while OTA has estimated minimum increases of nearly 12 percent for dynamites and smokeless powders, 15-17 percent for boosters and blasting caps, and over 23 percent for detonating cord.

This, as the report notes, will have an

impact on users of explosives. If your implementation program would result in more intensive levels of tagging than the OTA-designed "baseline" program, this cost impact could result in serious economic problems for several industries.

a) From a law enforcement standpoint, are you able to live with the large numbers of last legal purchasers of any given tag code that would result from OTA's proposal to uniquely tag an entire shift's output, rather than the 2,000 - 5,000 pound quantities you had earlier proposed. The OTA proposal would appear to provide a list of last legal purchasers that could approach 20,000 persons for any given tag code.

b) Given the British experience in Northern Ireland, where the IRA has circumvented tight explosives controls by using home-made explosives, particularly ammonium nitrate fertilizer, do you believe it might become necessary to tag at least the ANFO that is produced as an explosive? If so, what would be the cost impact? If not, why would you not expect bombers to switch to this for their activities?

c) Do you believe there is any chance that these cost increases, and the increased liability to explosives manufacturers predicted by OTA, will drive any companies out of business, or any products off the market?

ANSWER: The ATF figures for the cost increases to explosives makers that you are quoting are for the identification tagging portion of the program, while the OTA figures you cite are for identification and detection tagging. ATF and OTA cost estimates are in very good agreement.

The OTA analysis shows that explosives user costs are even less, ranging from a 0:02% operating cost increase for underground metal mining to 1% for quarrying.

a) The OTA baseline tagging program, which provides for the identification and detection tagging of the explosives most often used in crime and excludes ANFO and blasting agents, would cost approximately $45 million per year. This program is similar to the ATF proposed tagging program and corresponds with the ATF estimate of $48 million per year.

The OTA baseline program would tag with one taggant code a full shift of the same product, rather than adopt the ATF proposal to tag a specified weight of the same product in a single shift with one taggant code. The OTA baseline program would sometimes result in a larger quantity of explosives tagged with the same code and, therefore, a larger list of purchasers for any given taggant code.

Our research does not, however, indicate that a normal explosives batch would go to so many distributors and users that the workload for the explosives tracer and the bomb investigator would be prohibitive.

The Aerospace Corporation with the assistance of the National Explosives Tracing Center and several explosives makers studied the commercial distribution patterns of packaged, cap-sensitive explosives. Aerospace found that the average production lot size was 22,500 pounds distributed through an average 3.3 primary distribution points to 14.9 total distribution points. The effect of doubling the lot size to 45,000 pounds is to increase the number of primary distribution points by 76% from 3.3 to 5.8 and to increase the number of total distribution points by only 22% from 14.9 points to 18.2 points. This shows that the number of final purchasers does not increase significantly as the packaged, cap-sensitive explosives production lot size increases. Also, frequently, the primary search pattern is narrowed by geographical considerations so that not all distribution points need be contacted during the initial investigation.

The distribution network of the smokeless powders has not been studied in as great a detail as the packaged, cap-sensitive explosives network. However, it is known that there will be a greater number of total distribution points per lot size for these products.

b) ATF intends to tag only those explosives used in crime. ANFO and other blasting agents are rarely used in bombs. The more sophisticated criminal might use homemade explosives in response to the introduction of a tagging program. However, in our judgment, the effect of this would be limited by the increased risk of premature detonation and the reduced reliability and effectiveness of bombs fabricated from homemade explosives. Moreover, commercial detonators and booster charges, used to initiate the blasting agents, would be tagged. They would also likely be used in criminal bombings, further limiting the effectiveness of this response.

We believe, as OTA concluded, that the British experience in Northern Ireland is not directly applicable to the United States. The IRA is a centrally controlled and coordinated organization with tremendous technical expertise. Most bombings in the United States, however, are carried out by individuals, not organized groups. Nor is there evidence that this situation will change radically following institution of a tagging program. Furthermore, OTA notes that "Fabrication of detonators is a much more complex and dangerous activity than fabrication of explosive materials, and could probably be accomplished only in a well-equipped central facility." It further discusses the limited impact this would have on the effectiveness of the taggant program and points out "Commercial detonators would still be needed . . . ." Finally, an OTA consultant, in discussing the various methods of making ANFO-type materials cap-sensitive, states: "In all these cases of 'cap sensitivity', however, a high powered detonator (e.g. one containing 1 g base charge) is still needed, and also a certain amount of special information is required . . . ." Tests have shown that identification taggants from the detonator survive an explosion in untagged boosters. In addition, taggants, added as pellets to boosters, have also survived detonations.

ATF does not feel that tagging blasting agents, such as ANFO, is justified in view of the facts that blasting agents are rarely used in crime, and that the criminal use of blasting agents would normally require the use of a tagged blasting cap and/or tagged booster charge.

c) BATF has estimated that the cost increases for specific explosives products resulting from both identification and detection tagging would be 8% for cap-sensitive dynamites, gels and slurries, 1-2% for powders, 7% for blasting caps, 14% for boosters, and 23% for detonating cord. These estimates agree well with OTA's findings (There is a disparity between the OTA and ATF cost increase estimates for the powders. This disparity is resolvable through additional research and analysis.).

We do not feel that these cost increases would drive companies out of business, especially since the cost of producing tagged explosives would be passed along to the explosives users. An analysis of the increase in cost to the actual users has been made. Over 85% of all commercial explosives are used in mining; however, the cost of the explosives accounts for a very small percent of mine operating costs. OTA has estimated that a baseline tagging program would increase mine operating costs by 0.02% for underground metal mining, 0.2% for underground coal mining, 0.03% for open-pit metal mining, and 1% for quarries. As far as the impact beyond simply the increase in cost to consumers, ATF agrees with the OTA statement that "It is not expected that costs of this magnitude would lead to any major shifts in the patterns of production and use of explosives."

QUESTION: The OTA report notes two compatibility problems - the tags appear to react with both Hercules brand smokeless powder and cast boosters, at least under some conditions.

a) Do you believe the tests which uncovered these incompatibilities are valid? (If not, why would Aerospace contract with the manufacturers for these tests to be performed).

b) Given that the tags are going to be mixed with explosives in quantities on the order of one pound of tags per each ton of explosive material, do you anticipate any problems achieving an even mix of tags in the explosive?

c) As you know, the GOEX Corporation has filed a claim for damages against Aerospace for $2 million, alleging that tagged explosives caused an explosion which destroyed their plant in Camden, Arkansas.

1) Were you aware that Aerospace was signing test contracts with explosives manufacturers which contained a clause indemnifying them (the manufacturers) against any loss or damage as a result of performing the tests? What is the legal situation involved in that - if the GOEX claim, or any other

one, were upheld, would the government or Aerospace be liable?

2) Do you anticipate further such claims if the tagging program were to proceed?

ANSWER: a) Compatibility and safety are, and always have been, of primary concern in the development of taggants. Many of the tests performed are generally classified as "overtests." "Overtests" are valid screening tests whose results are beneficial in directing additional test programs and procedures. In "overtests" one subjects the test materials to an excessively stringent set of test conditions. If the tests result in no reaction, then one is confident that no undue risk is likely to be encountered during normal use. However, if the tests show evidence of reactivity (as was observed in the Modified Taliani testing of the tagged Herco (TM) smokeless powder and one formulation of cast booster material), then one must conduct a battery of tests to determine the cause and extent of the reaction.

ATF has contracted for the performance of these additional tests. A complete analysis of these data will show whether or not an incompatibility exists. If a safety hazard is identified, measures must and will be taken to ensure that the safety and performance of commercial explosives are not compromised by the addition of taggants.

It is not unusual to encounter problems in an R & D effort. We have encountered difficulties before in the tagging program and made adjustments to the taggants to correct for these. It is the goal of the smokeless powder testing program to assess the compatibility of the taggant with the smokeless powders and to indicate what, if any, adjustments must be made in the taggant to ensure that its addition does not compromise the safety, performance, and storage characteristics of these commercial products.

b) Mixing of taggants with explosives and propellants presents a wide range of conditions and manufacturing practice. It is possible (and has been observed) for taggants to be poorly mixed as a result of poor procedure or an inadequate mixing time. In the majority of cases, mixing of the taggants will be no better or no worse than the mixing of the other ingredients in the explosive.

For propellant powders, test data are available for black powder. Mixing of taggants with black powder in the normal glazing operation resulted in a uniform mixture. Simulated transportation of the tagged powder did not result in any detectable segregation.

For smokeless ball powder, a similar test result has been obtained. Mixing of similar size encapsulated taggants with Olin ball powder resulted in a distribution that remained apparently uniform after extended vibration and transportation; however, the difficulty of removing the taggants from the powders was such, and the amount of magnet-sensitive, non-taggant material found in the powder was so great, that a quantitative assessment could not be achieved by Olin Corporation. For cylindrical and flake smokeless powder, less definitive data are available. Preliminary results indicate that uniform mixing is achieved with similar size taggant particles. Further work is in progress to ensure that this critical issue is resolved.

c) 1) ATF was aware that Aerospace has occasionally found it necessary to include indemnification clauses in its contracts with explosives manufacturers. No indemnification provision applied to the GOEX claim.

The contract with Aerospace contains the customary cost-plus-fixed-fee (CPFF) clause regarding insurance and liability to third persons. Under it, the allocable portion of third party liabilities, which are not covered by insurance, would be reimbursable contract cost.

c) 2) Aerospace is convinced that the GOEX claim is unfounded. It is, of course, impossible to gauge, but we would not anticipate any future claims.

QUESTION: The OTA report makes it very clear that existing tags can be removed from both powdery high explosives and the gunpowders. It appears that an opaque tag which was testified to by Aerospace personnel before the Senate Governmental Affairs Committee does not exist at this time, and that its use would impose quality control problems for both the tag manufacturer and the explosive manufacturer.

It also appears that because the tags do not match the size or shape of any of the more than 30 different types of gunpowder, they could easily be removed by screening from gunpowder even if they were made opaque.

a) Were you aware that the tags which were presented to the Government Affairs Committee as a solution to the removal problem were not in fact opaque, as the Aerospace witness stated they were? Were you aware of the quality control problems that apparently would accompany their being made opaque?

b) The OTA report notes that the 3M Company, the tag manufacturer, was unable to provide any firm cost estimates for an opaque tag. Do you know why?

c) The report suggested that the tags could be made non-removable by somehow making them into pellets which matched the different types of powder grains.

    1) Do you know if this is feasible? If so, please provide the Committee with whatever documentation exists as to the feasibility, and the results of any tests demonstrating this.

    2) Making tags for powders in this manner would require the production of a rather small amount of uniquely shaped tags for each of a large number of different powder grades. Do you have any estimates as to what this might cost?

d) The report also stated that it would be necessary to make the tags non-magnetic to forestall removal. Since the report found that tags were unlikely to be recoverable by their fluorescent properties, and that such attempts might even be counterproductive due to the difficulties involved, how would you plan to recover non-magnetic tags from a bombing? (Please assume for the purpose of this answer that OTA's comments on visual recovery are correct.)

e) The general thrust of the OTA report's comments on tag removal are considerably at odds with the statements the

Aerospace Corporation personnel have given to Committees of both the House and Senate. How do you account for this? In particular, were any tag removals attempted before the testimony as to the difficulties of removal was given?

ANSWER: a) The opacification of taggants is one example of the technology that can be applied to make taggant extraction an even more unlikely countermeasure. At this time we view such technologies as contingencies to be researched as circumstances may dictate.

The opacified taggants presented to the Governmental Affairs Committee and later to Senator Stevens' staff are not completely opaque but are sufficiently opaque to make taggant extraction more difficult. They were intended to be representative of a concept to opacify the taggant, and do not represent the results of a detailed R & D effort.

We realize that opacification may introduce a need for some special handling of the taggants because of the opaque nature of the coating. Additional research and development is required to measure the extent of the special handling and quality control problems, but it is difficult to imagine that these will present major obstacles to the program.

b) The 3M Company conducted a 10-month study on the problems and methods involved in scaling up from pilot production of taggants to large-scale production for support of a national tagging effort. One of the products of this study was a firm cost quote for taggants and a delivery schedule. The 3M Company had carefully analyzed all the production and market variables in providing this information, which did not include the opacification of the encapsulant. It could not provide any additional cost/schedule quotes for variations on the baseline case to OTA without a similar careful review and deliberation.

c) 1) The taggants have been added to black powder and three smokeless powder configurations. In two cases, that of black powder and Olin ball powder, taggant particles having the same size range as the powders were added; and in these cases in particular there is a similarity in shape between powder grains and taggant. Sieving has proved to be an ineffective means of removing taggants. In actual tests, Olin was unable to remove the magnet-insensitive taggants from its smokeless powder without destroying the powder. Similarly, destruction of black powder was encountered during efforts to separate the magnet-insensitive taggants from the powder.

The other two shapes, rods and flakes, present a somewhat different problem. For rod type propellant, taggants having the same sieve size (but still spherical) were added. E. I. Du Pont encountered difficulty and did not separate the magnet-insensitive taggants from the powder grains, during Aerospace contracted tests, in spite of their dissimilarity in shape.

For flake or disc powders, sieving removal of taggants is even less likely if a similar size matching is employed. Standard taggants (spheroidal shape) are readily available in a range of sizes to meet any basic sieve size requirement. Thus, preliminary evidence suggests that sieving will not be an effective means of removing taggants from powders.

Although there is little justification for assuming that regular spheroidal taggants having a gross size match to smokeless powder or black powder grains can be removed by sieving, the possibility was considered and a method of producing shape-matched taggant particles was investigated.

The 3M Company produced a small quantity of taggant in the form of rods having dimensions very similar to those of a smokeless powder. These rods could be produced in a variety of sizes if desired. Because the materials were unchanged, no testing beyond mixing with a small quantity of smokeless powder and observation under a microscope was carried out. This effort was a preliminary one designed only to verify that an alternative geometry could be readily developed.

What we are reporting here are test results conducted by The Aerospace Corporation, E. I. Du Pont de Nemours and Company, Inc., and Olin Corporation. It is possible that given enough motivation and skill and using a proper set of tools and procedures, someone may be able to extract taggants from these powders. However, we agree with OTA that there is much that can be done to make the taggant more difficult and tedious to extract from explosives if necessary. Further, as OTA found, "The law enforcement experts whom OTA consulted predict that many terrorists and other criminals would probably not avail themselves of countermeasures that were theoretically available to them."

We are including with these responses The Aerospace Corporation report, "Feasibility of Identification Tagging of Black Powder," dated March 1979, the E. I. Du Pont report, "Process and Product Taggant Compatibility Demonstration Test for Du Pont Smokeless Powder, Phase I," dated February 1, 1980, and will forward a copy of the Olin Corporation report as it becomes available to us.

c) 2) The cost of such shape-matched taggants is not known; however, Aerospace estimated in its April 1979 Inflation Impact Analysis that such material could be produced at an additional cost of $10 per pound when compared to the regular encapsulated taggant cost. This estimate was based on the Aerospace experience and is not backed by a firm quote.

d) One of the options available for making taggant extraction more difficult is to make a mixture of magnet-sensitive and magnet-insensitive taggants for use in some explosives. The magnet-insensitive taggants will be recoverable by the UV-excited phosphor method and the slurry method.

We should point out that the recovery exercises in which OTA, NRA, and a representative of the explosives industry participated were conducted on an explosives range at Fort Belvoir. This introduced some nontypical conditions which made visual taggant recovery more difficult. Recognizing this fact, OTA stated: "It should be noted that the automobile tests conducted represent rather severe tests of recovery . . ." and reported that "Visual recovery may, in fact, be possible in situations such as an automobile bombing on a large paved area, or a small bomb in a large building."

It is the present standard procedure for ATF to examine in detail all available debris in the course of bomb scene investigation, looking for all possible evidence, including taggants. In the McFillin case, taggants were found visually during normal debris examination in the laboratory. Additional taggants were then found visually at the bomb scene itself.

e) ATF, Aerospace, and OTA are in general agreement that under certain circumstances taggants can be extracted from certain explosives provided a suitably knowledgeable criminal is well enough equipped and motivated. We believe also that there is a large body of technology that can make taggant extraction more difficult, such as the use of magnet-sensitive and magnet-insensitive taggants, and the use of opacifiers.

There have been several tests conducted by The Aerospace Corporation and others to determine the conditions under which taggants can be extracted and to measure the effectiveness of various techniques. A portion of these tests was performed prior to the March 1979 testimony in which it was mistakenly stated that taggants cannot be extracted.

Following this testimony a more complete study was conducted. The results of that study were included in The Aerospace Corporation testimony before the Governmental Affairs Committee on May 7, 1979. The conclusions of this study were: (1) that many but not all taggants can be removed from dynamites, slurries/water gels, and emulsions with an extended, determined effort; those remaining may well be sufficient in number for recoverability; and (2) the taggant extraction has a high probability of causing the repackaged explosive to fail to detonate properly or not at all, i.e., it may severely reduce the reliability of the explosive to which it has been applied, depending on the explosive chosen, the skill, knowledge, and motivation of the individual attempting the extraction, and the tools available to him.

QUESTION: How much money has thus far been expended on the taggant research program?

Please break down the figures for identification tagging, detection of tagged explosives, and detection of untagged explosives.

Can BATF define separate projects on which money has been expended?

ANSWER: A breakdown of the R & D expenditures on the Explosives Tagging Program is as shown.

	(000) Identification	(000) Detection	(000) Untagged Detection	(000) Total
FY-1977	801	279	20	1,100.0
FY-1978	1,263	809	128	2,200.0
FY-1979	792	1,123	595	2,510.0
FY-1980	520	960	75	1,555.0
			Total:	7,365.0

There are currently ten identification tagging projects.

Color-Coded Taggant Development - Initial survivability/compatibility testing, pilot production capability, manufacturing lead time study and environmental impact assessment are the tasks that were performed in this project.

ID Tagging of Dynamites, Water Gels and Slurries - Compatibility testing, survivability testing, on-line tagging, methods of record/tracing, and complete analysis of the pilot test were performed.

ID Tagging of Black Powder - Technical readiness of tagging, successful survivability test program, testing for safety and manufacturing compatibility, segregation ballistics testing, and on-line tagging have been addressed in this project.

ID Tagging Cast Boosters - Survivability testing and initial compatibility testing have been performed using pelleted taggants.

Detonating Cord - ID and Detection Tagging - Tagging, design and construction of equipment to tag detonating cord, and compatibility testing were performed.

ID Tagging - Smokeless Powder - Manufacturing feasibility, ballistics testing (SAAMI-coordinated), and special compatibility were performed.

Detonators - Label Approach - ID and Detection Tagging - Feasibility of label approach was shown and survivability was tested.

Detonators - Double Plug Approach - ID and Detection Tagging - Microcapsules and ID Taggants impregnated into plug were tested, as was the placing of ID taggants between double plugs.

ID Tagging - Magnetic Taggant Development - Curie point taggant fabrication and survivability tests were performed.

ID Tagging - Explosion Induced Magnetic Color-Coded Taggant - Search for suitable material was performed that would become magnetic only after exposure to detonation.

There are currently eight detection tagging projects.

Vapor Taggant Selection - Two subcontracts awarded for taggant physical property investigations with blasting cap elastomer components.

Microencapsulated Taggant Development - Two subcontractors have been developing microcapsules with optimized wall material, wall thickness, and vapor. Extensive environmental and health impact studies, emission tests, and initial compatibility tests with explosives have been performed.

Tagging of Dynamites, Water Gels and Slurries - Various simulated explosives have been tagged. Long-term emission rate tests, under various thermal and humidity conditions, are being performed.

Tagging of Black Powder - Initial compatibility has been performed.

Tagging of Cast Boosters - Some compatibility has been performed.

Tagging of Smokeless Powder - Compatibility testing being performed.

Tagging of Detonating Cord - Tagging, design and construction of equipment to tag detonating cord, and compatibility testing were performed.

Detection Sensors - A preliminary list of user requirements and corresponding performance specifications for the detection system has been compiled. The Ion Mobility Spectrometer, the Continuous Electron Capture Detector, the Mass Spectrometer, and animals are being worked on.

And there is currently one untagged detection project.

Untagged Detection - The use of dielectric detection has been considered and an analysis, design, and partial construction of a computerized tomography system have been performed to detect untagged explosives.

QUESTION: How was Aerospace chosen as the contractor for the tagging research?

How much has BATF paid Aerospace for its work on tagging? Can you give us figures for each year that Aerospace has been under contract?

ANSWER: In 1976, the Congress appropriated $1.2 million to be used for implementation of the necessary research and development activities to make possible an effective explosives identification program (Senate Report 94-953, June 16, 1976, 94th Congress, 2nd Session).

ATF responded to this requirement by the Congress by establishing a program for development of methods for the detection and identification of illegally used explosives. An Advisory Committee on Explosives Tagging and a Technical Subcommittee of that Advisory Committee had been established, and research contractor requirements were now drawn up.

For purposes of the contractor requirements, it was recognized that:

- Specific program requirements could not be adequately defined for the general industry to competitively and firmly bid against these requirements.
- The contractor would have to be experienced in research and development and neither a manufacturer of explosives nor a manufacturer of equipment for use in tagging.
- The contractor would have to possess familiarity in all relevant technological disciplines; technical objectivity; suitable depth and breadth of technical talents; and have a demonstrated ability in systems engineering and engineering management.

The Aerospace Corporation, Planning Research Corporation, MITRE Corporation, and the Franklin Institute briefed ATF on their capabilities to conduct tagging research. The Institute for Defense Analyses was invited to brief ATF but declined. Following the briefings it was determined to be in the best interests of ATF and the research program to select among the three not-for-profit research organizations--the Franklin

Institute, The Aerospace Corporation, and MITRE Corporation.

ATF awarded a selected-source contract to The Aerospace Corporation based on its unique qualifications, including greater diversity of scientific expertise, capabilities and experience, and compliance with contractor requirements. The Aerospace Corporation was and continues to be uniquely qualified to be the contractor for the explosives tagging research program.

The following table shows the allocation of research funds by The Aerospace Corporation for Fiscal Years 1977 through 1980.

EXPLOSIVES TAGGING & CONTROL BUDGET HISTORY

	(000) FY-77	(000) FY-78	(000) FY-79	(000) FY-80
Subcontracts, consultants & purchased services	309.1	926.7	1,236.2	498.4
Aerospace technical(1) management of subcontracts	155.1	362.4	411.9	338.7
Aerospace in-house research & development	265.1	655.8	683.9	589.7
Aerospace technical(2) support	70.7	163.1	178.0	128.2
Yearly Total	800.0	2,108.0	2,510.0	1,555.0

Total: 6,973.0

(1) includes Aerospace writing of reports on subcontractor activities and travel.

(2) includes monthly report and presentations, annual report, advisory committee support, answers to technical questions, symposium, general administration.

QUESTION: How was Management Science Associates (MSA) chosen as the group to conduct the cost/benefit study on explosives tagging?

How much was MSA paid to do the study?

ANSWER: Management Science Associates (MSA) was selected for the cost/benefit study from competitive bidders to Solicitation BATF-77-B-750 published in the Commerce Business Daily in 1977. The selection was based on the merits of MSA proposal in accordance with Federal procurement requirements. The contract cost was $166,725.00.

QUESTION: How many outside subcontracts have been awarded by Aerospace on tagging research?

ANSWER: The Aerospace Corporation has awarded 87 subcontracts to date. It is expected that 17 more subcontracts will be released in the rest of FY-1980.

QUESTION: Are there any other government-funded research programs in the field of explosives detection? Please provide a summary.

ANSWER: Yes, there are several other government agencies engaged in explosives detection research and development. The Federal Aviation Administration (FAA) conducts the largest of these activities. Currently, the main thrust of the FAA's work is aimed at the detection of explosives in luggage, packages, and parcels. These techniques are generally not applicable to personnel searches, as the methods used expose the article of search to x-ray or neutron radiation. One technique, nuclear magnetic resonance, may be suitable for use on personnel searches.

More modest programs are being conducted by Sandia Laboratories for the Department of Energy (DOE), the Department of Defense (DOD), and the Nuclear Regulatory Commission (NRC). The DOE and NRC programs are aimed primarily at the detection of explosives vapors, and the techniques being investigated are suitable for personnel searches. The DOD program is targeting land mine detection.

Small programs involving mainly literature search activities are being maintained by the State Department and the Secret Service. The U. S. Postal Service (USPS) and the Law Enforcement Assistance Administration (LEAA) conducted research programs but no longer are actively pursuing explosives detection research.

All of these agencies have been helpful in ATF's efforts to develop detection taggants. All are represented on our Explosives Tagging Advisory Committee. This assists each agency in avoiding unnecessary duplication of efforts.

OTA reviewed the progress of some of these R & D efforts and found that ". . . none of the approaches, with the exception of nontagged vapor detection (developed by the

FAA for luggage checks and not suitable for personnel searches), has progressed as far as the detection taggant research and most appear to be significantly more expensive, both for the instrument and for personnel to man the instrument."

QUESTION: What is the current status of the program with respect to testing and implementation dates?

ANSWER: There have been many accomplishments in the tagging program. The identification tagging research and development has resulted in a taggant that survives an explosion and is recoverable. A successful pilot test of the use of taggants in packaged, cap-sensitive explosives has been completed in which over 6 million pounds of dynamites, water gels and slurries were safely tagged, distributed, and used. It was, in fact, from this test series that Mr. McFillin acquired the tagged explosives that he used to murder his nephew. The taggant was a valuable part of the investigation and prosecution of this case for which Mr. McFillin received a 30-year sentence.

Currently, we are completing our identification taggant preliminary safety and compatibility tests on smokeless powder, cast boosters, detonating cord, and detonators. These tests include laboratory determination of reactivity, sensitivity, and compatibility. A battery of ballistics tests involving a SAAMI-coordinated 150,000-round firing of tagged smokeless powders is also being conducted. These R & D activities will continue through FY-1981.

The detection tagging R & D program has also had significant accomplishments. Aerospace efforts have resulted in the identification of five acceptable vapors with the necessary performance characteristics. These characteristics include negligible impact on the environment and good detection characteristics. A means to control the vapor release rate through the use of microencapsulation is now being developed and tested with good preliminary results. Three primary candidates of detection vapor sensors are also being investigated.

Detection tagging development is not as far advanced as identification tagging development. The preliminary safety and compatibility tests are now being conducted, and prototype detection sensors suitable for field testing are now being planned. Techncial readiness of these systems could extend through FY-1982.

In accordance with the Congressional mandate, no activities relating to implementation have been undertaken.

QUESTION: How much do you expect the overall cost of the program to be, including both government and industry expenses? By how much is the program expected to raise the costs of various types of commercial explosives? Do you expect an economic impact beyond simply the increase in costs to consumers?

ANSWER: The Inflation Impact Analysis prepared by The Aerospace Corporation estimates an annual cost of $48 million for the identification and detection tagging of packaged, cap-sensitive explosives, cast boosters, black powder, smokeless powder, detonating cord, and blasting caps. This estimate is in good agreement with the OTA "baseline" program cost estimate of $45 million per year.

The Aerospace cost analysis translates to an 8% increase in the price for packaged, cap-sensitive explosives, 14% for cast boosters, 1% for black powder, 1.7% for smokeless powder, 23% for detonating cord, and 7% for blasting caps.

This study did not formally extend to the economic impact beyond the increase in cost to consumers. OTA has stated that "It is not expected that costs of this magnitude would lead to any major shifts in the patterns of production and use of explosives."

The OTA report cites, for example, the increased explosives costs will increase the cost of operation 0.02% in underground metal mining, 0.03% in open pit metal mining, 0.2% in underground coal mining, and 1% in quarries and above-ground dam construction.

QUESTION: What impact do you expect this program to have on terrorists (as distinct from common criminals)? In how many terrorist bombings in 1978 (or 1979 if figures are available) could taggants have been of assistance had the program been operational? Please use specific figures.

ANSWER: Bombs are an implement of terror designed to kill, maim, and destroy in a brutal and heinous manner. What separates the terrorist from the criminal is not the weapon, but rather the motivation. The terrorist is generally motivated by political considerations where the criminal is profit-, greed-, or revenge-motivated.

ATF does not keep separate statistics on terrorist bombings; however, ATF investigated over 1,400 explosives bombings that killed 23 people, injured 435, and destroyed over $17 million of property in 1978. If a tagging program like the one ATF is developing or like the OTA baseline program had been in effect, at least two-thirds of those bombings would have involved taggants.

The recent OTA report, "Taggants in Explosives," noted that in 1978, 107 of the bombings reported to the FBI were terrorist bombings. The OTA report concluded that ". . . both identification taggants and detection taggants would be useful law enforcement tools against most terrorist and other criminal bombers."

Terrorists frequently use commercial explosives in their bombs. In 1976 an FALN "bomb factory" was discovered and seized in Chicago, Illinois, and in 1978 a second FALN "bomb factory" was found in New York City. The explosives seized in both of these cases contained commercial dynamite. Because the date/shift code markings were intact on these explosives, a trace was successful in determining that both factories contained explosives stolen in 1975 from a Denver, Colorado mining company, establishing an important connection between the two "factories." The identification taggant contains the same valuable information as the date/shift code marking. But unlike the date/shift code marking, the taggant survives the bombing.

QUESTION: Is there any point at which increasing costs for the program would outweigh its benefits to law enforcement?

ANSWER: The ATF explosives tagging program is designed to obtain maximum utility at a minimum cost. Consequently, we intend to tag those explosives most often encountered in bombings. These explosives include the packaged, cap-sensitive explosives and bulk black and smokeless powders sold in cans which account for about two-thirds of the bomb fillers identified in 1978. We also intend to tag cast boosters, detonating cord, and blasting caps which are commercially used to detonate blasting agents and explosives.

ATF and OTA analyses indicate that the extension of the tagging technology to blasting agents would provide a rather small incremental increase in utility to law enforcement while being significantly more costly. Our judgment is that since blasting agents are encountered in less than 1% of the bombings and are so extensively produced (and hence costly to tag), it is wiser to tag the cast boosters, detonating cord, and blasting caps which are normally used to detonate the blasting agents.

QUESTION: Do you support the Aerospace Company's contention that the results of safety tests given to one explosive may be presumed to apply to other similar explosives, and that therefore not all explosives need safety tests before tags could be required to be placed in them?

ANSWER: We support The Aerospace Corporation position that safety tests conducted on one explosive may apply to other similar explosives provided that the ingredients are the same and that the amounts of each ingredient differ only within reasonable limits. This appears to be the position taken by some members of the explosives industry as well. E. I. du Pont de Nemours and Company, Inc., in its report to The Aerospace Corporation on the safety testing it did prior to the National Pilot Test, stated: "The purpose of the tests was to qualify the taggants for use in water gel explosives. It must be understood that the tests do not qualify the use of taggants in other explosive products though some of the test data may be relevant." Similarly, Hercules Incorporated, in its report on the safety testing that it designed for its dynamites and slurries, states: "A test program was proposed that would demonstrate the magnitude of any effect tags might have on the sensitivity of the explosives which were selected as representative."

QUESTION: Last year you testified that you were ready immediately to tag certain types of explosives had you been given the authority. Do you believe you are still ready to proceed with implementation for these explosives?

ANSWER: Sufficient data and analysis exist on safety, compatibility, recordkeeping, and other matters on dynamites, water gels, slurries, and emulsions to assert that the implementation process could be initiated. This does not mean that tagging of all explosives in the above category could begin immediately. The implementation process includes elements such as the final qualification tests and the construction of a taggant production facility. This process would likely take 18 to 24 months to complete.

QUESTION:	Please supply copies of all testing and other performance reports that Aerospace has supplied BATF since 1977.
ANSWER:	We are attaching 2 copies of these reports for your information.

FEDERAL LAW ENFORCEMENT TRAINING CENTER

STATEMENT OF ARTHUR F. BRANDSTATTER, DIRECTOR

ACCOMPANIED BY:

RICHARD J. DAVIS, ASSISTANT SECRETARY, ENFORCEMENT AND OPERATIONS
ARTHUR D. KALLEN, DIRECTOR, OFFICE OF BUDGET AND PROGRAM ANALYSIS, DEPARTMENT OF THE TREASURY
DAVID W. McKINLEY, DEPUTY DIRECTOR
JOHN C. DOOHER, ASSISTANT DIRECTOR, WASHINGTON OFFICE

PREPARED STATEMENTS

Senator CHILES. Our next agency will be the Federal Law Enforcement Training Center.

The committee will now receive testimony regarding their fiscal year 1981 budget request and their fiscal year 1980 supplemental request.

The committee is pleased to have Mr. Davis and Mr. Brandstatter with us. We will submit your full statement in the record.

[The statements follow:]

STATEMENT OF RICHARD J. DAVIS

Mr. Chairman and members of the Committee, it is a pleasure to appear before you in support of the fiscal year 1981 appropriation request for the Federal Law Enforcement Training Center. At this time, I would like to introduce Arthur D. Kallen, Director, Office of Budget and Program Analysis for the Department of the Treasury, Arthur F. Brandstatter, the Director of the Center, David W. McKinley, Deputy Director of the Center, and John C. Dooher, Assistant Director for the Washington Office.

Before Mr. Brandstatter reports on the specific operations of the Center, I would like to highlight several significant developments.

The 1981 budget request is for $13.4 million and is $2,000 less than the proposed authorized appropriation level for 1980. As is the case in the current year, the Center's request is in accordance with the Administration's program of fiscal restraint by keeping federal expenditures to an absolute minimum. Therefore, the Center's budget for training reflects the continued general reductions being experienced government-wide by federal law enforcement organizations. This reduced request will permit the Center to once again ensure a funded average resident student population of 525. The Center will continue to provide training, support and facilities for participating organizational personnel above this level on a reimburseable basis. The fiscal year 1980 supplemental request for pay is $399,000.

As part of the Center's appropriation in fiscal year 1980, Congress allocated funds for the expressed purpose of reducing the backlog of training in the White Collar Crime Seminar for the newly formed Inspectors General offices. I am pleased to report that the Center has taken measures to greatly dissipate this backlog by increasing both the number of students per class and the frequency of course offerings. At the same time, through the combined efforts of the Center's staff and several participating organizations, the White Collar Crime program has been strengthened both in terms of the quality of the course content and presentation. This course has been extremely well received and continues to be in high demand. In a small but very significant way, the success being achieved in this cooperative venture demonstrates the virtue of a consolidated training center.

In connection with the developing training needs of the various Inspector General offices, I should point out that officials of the Department and the Center are working closely with this group. We are actively participating in discussions with the Inspectors General Council and in a training task force committee established by them to focus upon necessary training and career development. Currently, the Center is involved in a job analysis assessment being conducted by the Office of Personnel Management in conjunction with a cross section of Inspectors General personnel. This is expected to produce a number of short and long range training options for both investigators and auditors. As soon as the Council has an opportunity to decide on desirable courses of action, the Center and its Board of Directors will be ready to address their training requirements within the available budget and resource capabilities.

Another area I would like to call attention to concerns the construction program at Glynco. The permanent construction is approximately 90 percent complete and Treasury has accepted from the General Services Administration, and placed into operation, most of the major project items. There remain only a few construction activities, all of which are well underway, to be completed under the established master plan for development of the Center. Throughout this project, which has spanned a period of over four years, the Center has operated under circumstances which at times have been disruptive and very taxing to the staff. I believe it is a tribute to the Center's staff that they have reacted with remarkable flexibility, effectiveness and efficiency during this period. Since the commencement of operations in September 1975 through the end of fiscal year 1979, almost 26,000 students have attended courses of instruction at Glynco. As the construction program is concluded and the full use of our facilities is realized, we anticipate that the participating organizations will take even greater advantage of the fine capabilities of Glynco.

There also continues to be a trend toward greater use of the Center by more agencies. During the past year the U.S. Customs Service completed the relocation of its patrol and inspection training from the Washington, D.C. area to the Center. Also, the Drug Enforcement Administration has initiated a study to determine the feasibility of relocating all or a major portion of its enforcement training activities to Glynco.

Finally, let me mention that the Board of Directors has approved the training of U.S. Customs import specialists and Bureau of Alcohol, Tobacco and Firearms regulatory personnel on a one year experimental basis. Although neither group completely meets the present eligibility criteria estabished for participation at Glynco, there is a growing recognition of the inter-relationship between special agent activities and the functions performed by these personnel. On this basis, the fact that certain economies would be realized by the government, and the desire to maximize the use of facilities, the decision was made by the Board to allow this training under a strictly reimburseable arrangement.

I now ask Director Brandstatter to proceed with more detail about the Center's budget request.

STATEMENT OF ARTHUR F. BRANDSTATTER

Mr. Chairman and members of the Committee, I am pleased to be with you again to report on the activities and accomplishments of the Federal Law Enforcement Training Center and to present our appropriation request for Fiscal Year 1981.

REORGANIZATION OF STAFF

I will open by informing you that we have recently completed a reorganization of the Center and a realignment of our staff to enable us to meet new and expanding training activities and to take full advantage of our staff's expertise.

The major feature of the reorganization is the consolidation of the staff of the Police and Criminal Investigator training units. This allows greater flexibility in instructor assignments and provides the opportunity for improved productivity. Additional increased productivity is anticipated by the merger of several training support functions.

One of the expanding activities I refer to is the diversity of training needs we are currently required to meet. While continuing to meet the recruit training needs of participating organizations, we have also been requested to provide training in advanced and specialized subjects needed by several organizations. As members of this Committee projected years ago, the Center has become the catalyst and focal point for improving the quality and economy of training for the federal government's law enforcement personnel.

In addition, because of the Center's excellent facilities and the cost efficiency achieved through the consolidation of support services, we are accommodating ever increasing numbers of Advanced, In-Service, Refresher and Specialized (AIRS) programs conducted by the participating organizations. These trends and their significance will be amplified further during the remainder of my remarks, and serve as evidence of the foresight of this Committee and other Congressional leaders in establishing a consolidated training center.

SALARIES AND EXPENSES

The fiscal year 1981 budget request for the Federal Law Enforcement Training Center is $13,400,000. This represents a decrease of $2,000 below the fiscal year 1980 proposed authorized level of $13,402,000. Increases in telecommunications costs, within-grade pay increases, cost of living, and other rising costs result in an increase of $753,000 to maintain current levels. This amount is offset by savings due to increased productivity, one less workday, and limiting the funding of travel to basic students only, which will produce an estimated savings of $755,000. Thus, a net decrease of $2,000 is projected for fiscal year 1981. The fiscal year 1980 supplemental request for pay is $399,000.

The fiscal year 1981 budget request provides funding to train 2,800 students in basic programs, representing 27,300 student-weeks, with an Average Resident Student Population (ARSP) of 525. In addition, based on information currently available, it appears that the Center will conduct training on a reimbursable basis for 8,980 students, representing 24,657 student-weeks and an ARSP of 474. Combined, this training reflects a total of 11,780 students, representing 51,957 student-weeks, and an ARSP of 999. This number may, of course, change as agencies adjust their projections as we get closer to the fiscal year.

Of the total student-weeks of training, 61 percent will be devoted to basic programs. They include those conducted solely by the Center, as well as those referred to as integrated programs which are conducted jointly by the Center and participating organizations. The remaining 39 percent of student-weeks of training will be devoted to AIRS programs. This compares to the fiscal year 1980 projections of 10,339 students, 49,852 student-weeks, an ARSP of 959, and a mix of 60 percent basic and 40 percent AIRS.

This overall increase of 1,441 students and ARSP of 40 can be accommodated with a budget that reflects a decrease of $2,000 for two major reasons. The first relates to limiting all or nearly all of the funding of travel to basic and integrated basic students only; and the second involves increasing the amount of reimbursable funding.

PLANT OPERATIONS

When the permanent construction program is completed during fiscal year 1980, the Center will be maintaining over 200 buildings on its 1500 acre facility. During fiscal year 1980 the Center will take possession of a number of new facilities including a 96-point indoor firing range, a classroom building to house basic training activities and the learning resources center, and a major expansion of the physical training complex. Additional projects to be completed during 1980 include the energy distribution and other utility systems, a driver training course, street and walkway lighting, and miscellaneous site work.

I would now like to comment briefly on the types of training conducted at the Center.

BASIC TRAINING

Basic training for recruit criminal investigators and police officers is conducted by the Center's instructional staff. These programs are designed to provide recruits with the specific knowledge and skills required for actual job performance. This is accomplished through a combination of classroom instruction and practical exercises designed to make the training realistic and job-related.

We are currently engaged in an interagency, multi-occupational job and task analysis which will enumerate all basic and common tasks performed by law enforcement personnel of each of the participating organizations. The results of this analysis, which will be completed during fiscal year 1980, will be used to further refine and validate our basic training programs.

Since I last appeared before this committee, the U.S. Customs Service has transferred all its law enforcement training activities to the Center. Previously, only basic training for special agents and Customs Patrol Officers had been conducted at Glynco, with the remainder of their training conducted in the Washington, D.C. area. Now, however, basic training for Customs Inspectors and all AIRS training for Customs law enforcement personnel is also conducted at the Center.

You will also be pleased to know that the U.S. Drug Enforcement Administration (DEA) has recently completed an internal task force study on the feasibility of transferring a portion of its training activities to the Center. We understand the results of the study are presently being reviewed by DEA and Department of Justice officials.

Criminal Investigator Training

The Center conducts a seven-week basic training program for recruit investigators. We estimate that during fiscal year 1981 we will train 1,051 students in this program.

Police Training

Nine different programs are conducted for recruit level police officers. Six programs, ranging in length from five to twelve weeks, are conducted entirely by Center instructors. In addition, Center staff members provide instruction in three integrated basic programs, which are conducted jointly with the participating organizations. They include programs of eight weeks for Federal Protective Service Officers, 14 weeks for Immigration Officers and 16 weeks for Border Patrol Agents. During fiscal year 1981, we expect that a total of 2,647 students will be trained in the various basic police programs.

ADVANCED, IN-SERVICE, REFRESHER AND SPECIALIZED TRAINING (AIRS)

Common AIRS

In response to training needs expressed by the participating organizations, the Center conducts AIRS programs that are common to personnel of two or more of the bureaus we serve. Our major effort in this area during fiscal year 1980 is being directed toward providing training in the investigation of White Collar Crime. As you recall, we received funding this fiscal year to reduce the large backlog of investigators and auditors who had requested this training. We are conducting the training now on a priority basis, and expect to have the initial backlog substantially reduced by the end of this fiscal year by graduating 680 students. We will continue the training during fiscal year 1981, and expect to graduate 180 students.

Other Center conducted AIRS programs planned during fiscal year 1981 include the one-week Advanced Law Enforcement Photography School, with 169 students; and the two-week Firearms Instructor Course, with 144 students.

Organization AIRS

Many of the participating organizations conduct AIRS training to meet their individual needs. The Center provides administrative and logistical support for these programs, with the organization personnel providing the majority of the instruction. Upon request, Center instructors also present portions of the training.

The number of AIRS programs continues to increase, as the participating organizations take greater advantage of the Center's facilities, support services, and cost efficiency. We estimate that 7,461 students will graduate from these programs during fiscal year 1981.

TRAINING SUPPORT, ADMINISTRATIVE STAFF AND PLANT MAINTENANCE

We are actively investigating the possibility of contracting for several of the support functions essential to the training operations of the Center. If this effort should result in economies without reducing quality, the Center will implement the contracts. We are currently using contract personnel to provide a portion of the security for the Center's facilities. We have also been gathering information to consider the feasibility of contracting for the transportation of students between the Center and nearby airports. We will also expand our contracts with local firms to assist in maintaining the new buildings and facilities.

We have continued to expand and refine our management information system and increased our use of computer programs to assist in the maintenance, storage and retrieval of records. We will endeavor to refine these systems to produce additional resources for planning and decision making.

The implementation of our student recreation and athletic program has enhanced the effectiveness of our training by providing outlets for student interests and energies while they are in residence at the Center. It has contributed substantially to our ability to provide a complete living and learning environment for students.

MAJOR MAINTENANCE

In fiscal year 1979, the Congress approved the use of $10,200,000 of previously appropriated construction funds for on-going requirements for repairs, alterations, minor construction and equipment for new facilities at Glynco. Through September 30, 1979, the Center had obligated approximately $1.4 million for these purposes.

CONCLUSIONS

Mr. Chairman and members of the Committee, it has been a pleasure to be here today to present the fiscal year 1981 appropriation request for the Federal Law Enforcement Training Center. We recognize that the success we have enjoyed in our effort to provide high quality training at the lowest possible cost has been made possible by your support and the excellent cooperation of the many law enforcement organizations we serve. We look forward to your continued support and guidance as we face the challenges that lie ahead.

My colleagues and I are available to answer any questions you may have concerning this appropriation request.

TRAINING FOR INSPECTOR GENERAL ORGANIZATIONS

Senator CHILES. Mr. Davis, as you remember, the House-Senate conference report that accompanied last year's appropriations bill requested the Department to develop a comprehensive program setting forth personnel and funding requirements to provide training support for the Inspectors General. In March of this year the committee received a letter from you which indicated that the Inspectors General have a study under development with respect to their comprehensive needs, and the Center was actively involved with the Inspectors General task force in preparing the plan.

What recommendations has this Inspectors General task force made to date? Is the funding request for the Center adequate to meet the needs of the Inspectors General?

Mr. DAVIS. Senator, first, the Center, in reaction to the interest of this committee, did take a series of steps over the last year and greatly expanded the availability of the white collar crime seminar that was developed.

Second, the Inspector General who was responsible to all of the Inspectors General for developing a training program was included on the Board of Directors of the Center to make sure we had that input.

Third, the Inspector General council developed a task force which the Center worked with and they have completed a report which identifies the various tasks that would be necessary, in terms of duties that the Inspector General personnel must perform, in order to develop the proper training. That report was recently distributed to each of the Inspector General organizations and final comments are awaited.

We have been working to develop the courses to meet what that report shows. In terms of the funding, whether or not we have sufficient funds in our base--that is, whether we could train these people in basic training without reimbursement—would depend upon the training load that we have. We have a 525 funded average resident student population. All of the additional training above 525 would be normally on a reimbursable basis.

So it may be, in terms of the budget that is being submitted, that a major expansion in the Inspector General participation, at least the first year, would be done on a reimbursable basis.

Mr. Brandstatter, Mr. Dooher, and Mr. McKinley, who I should introduce as being with me, should have some more information since Mr. Dooher participated personally in the work of the task force.

INSPECTOR GENERAL TASK FORCE

Mr. BRANDSTATTER. Mr. Chairman, I have met with the Inspector General who chairs this particular task force that conducted this study which has been submitted to the various Inspectors General.

You may be interested in knowing that the task force called on the Office of Personnel Management's Consultation Division, to help them with this development. We anticipate that in the near future the HUD Inspector General, Mr. Dempsey, who is a member of the Board of Directors of the Center, will present a proposal for the Board's consideration. We will be expected to react to that proposal in terms of our ability to respond to the requests that will be made and in terms of our ability to fund the program unless it is on a completely reimbursable basis.

FUNDING OF INSPECTOR GENERAL TRAINING

Senator CHILES. At this time you don't have any information to give us as to whether you do have the resources within your base or whether you are going to need additional money?

Mr. DAVIS. I think, Senator, it is likely—and this is not necessarily unusual for new programs—once this new program is put on line, that we would not have budgeted funds for it in our base. Normally as in other situations it would be done on a reimbursable basis. We had hoped, obviously, as you, to have been further along at this point.

Senator CHILES. I certainly hoped so, too. I hope we are not looking at another year's delay.

Mr. DAVIS. I don't think you are looking at another year's delay in the training. The question is whether it is done on a reimbursable basis or not.

We are waiting, however, essentially for our customers, whom we are working with, to identify their needs. The Center has the physical plant and has the ability to do the training. As I say, whether it comes within that funded pipeline, which in the past few years has been reduced is a separate question.

FISCAL YEAR 1981 PROPOSED FUNDING POLICIES

Senator CHILES. My understanding is in fiscal year 1981 the Center has proposed to pay for 100 percent of the basic training with the Center's participating agencies paying for 100 percent of the advanced training. The current system is mixed, with the Center paying for both basic and advanced, is it not?

Mr. MCKINLEY. That is correct.

Senator CHILES. The advantage of this change will be that it substantially reduces the training Center's travel cost because individuals receiving basic training stay longer and; therefore, on the average, there is less travel for those receiving basic training.

Mr. MCKINLEY. That is correct.

Senator CHILES. Will this result in an overall travel savings for the Government?

Mr. MCKINLEY. I wouldn't think so because if the workload remains high, somebody will have to pay for those travel costs. It will be borne by the participating organization rather than the Center reimbursing them.

Senator CHILES. Other than the obvious budget savings for the Center, are there any program advantages to this new system?

Mr. MCKINLEY. No, I wouldn't think so.

Mr. DAVIS. Except for one, Senator. I think we have to remember that the law enforcement training has two components: the basic and the advanced. I think the most important, by necessity, is the basic. There is no use in hiring somebody if they don't have any basic training because they can't, or shouldn't, do anything. It is the Board's policy to make sure that basic training is done so at least you have a law enforcement officer who can do something.

The advanced training is very desirable, but I think it is a lesser priority.

WHITE COLLAR CRIME SEMINAR

Senator CHILES. You have classified the white collar crime training as advanced. Is that going to discourage some of the agencies, now that they will have to pay the total cost, 100 percent of the cost of that, overall, as a result of that categorizing of advanced, is that going to discourage there being some training for investigation of white collar crimes, which is the greatest demand we find in the Government now and the most pressing need, to have training in that area?

Mr. DAVIS. Mr. McKinley and Mr. Brandstatter may want to amplify, but we have found over the past year, although a number of them were not on a reimbursable basis, there has been a big demand for the white collar crime seminar. We expect that will continue.

At the same time, white collar crime, of course, is just one course which exists now. The Inspectors General presumably will also want to develop some other training courses.

ADVANCED TRAINING

Senator CHILES. I make the same statement as to all advanced courses. I picked out white collar crime because you don't have it as basic training. You just have it classified as advanced. But for all of the areas, are we going to have outfits that say, all right, let's send people to basic training because the Center is paying for that, but let's not send or let's reduce the number of people we send to advanced because we have to pay 100 percent of the money for it?

Mr. DAVIS. There certainly will be more budgetary pressure on participating agencies to be more selective in the advanced training they do.

Senator CHILES. This is an area that I think overall the Congress is not looking to necessarily put great budgetary pressure on.

Mr. DAVIS. I mean the budgetary pressures of the individual agencies looking at their priorities.

Senator CHILES. I know that. We are talking about from our standpoint of how we set up the whole budget and whether we want to cause there to be budgetary pressure in the selection, let's say, of priorities between an agency of what they are going to do with their dollars.

The way you are designing it, it is very good from the Center's standpoint, maybe for your budget, but the way you are designing it I think you are making an agency be under more budgetary pressure.

What I see many of the agencies doing who don't consider it their greatest mission is to not send people for advanced training. Our problem with them before, was that they did not consider prevention and detection of fraud with the kind of degree that they should have considered it. So here we are going to put more pressure on them because they are going to pay for it 100 percent.

From the Congress standpoint, we might much rather fund the Center and let the Center be giving 100 percent for the training and advanced training of these agencies and know that we are then going to be able to encourage the agencies to get the training. Your approach would be to put pressure on them to select their priorities and knowing where they are putting the priorities to start with, that they are not leaning toward training for fraud, prevention or detection, our overall purpose would be defeated.

So I think you are giving us a situation that doesn't look to me like we would be doing a great thing for the thrust of the Inspector General movement, the thrust of white collar detection, the thrust of government accountability and credibility.

Mr. DAVIS. I would like to make two points in response. The first is that we are trying to look at the basic training course for purposes of putting into the basic investigative training elements of the white collar crime course, so those agents will be trained initially.

Second, in terms of the suggestion as to whether the Center should be funded additionally to cover 100 percent of the training, I think that is the point in an appropriations hearing when administration witnesses are not supposed to comment.

CENTER MISSION

Mr. BRANDSTATTER. It should be mentioned perhaps, Mr. Chairman, that we have a basic responsibility to supply all forms of training that the memorandum of understanding, on which the Center operates, and was signed by the Cabinet level departments several years ago, provided for basic training and advanced training.

It is incumbent upon the center to be fully funded in order to meet those training requirements. If we are not, it is essential for us to establish priorities within the Center.

It seems that, based on the Board's decision and the consideration of other issues, we have to concentrate on support of basic training when the funding becomes limited. I assure you that we have a responsibility to meet the advanced training that is required for these agencies to continue to perform and meet their mission. But funds are important for us and it is essential that we be staffed adequately and be funded accordingly if we are going to meet these commitments.

The Center has been doing this, and when we have classes canceled, it is important to know that for inservice training programs that are held in abeyance, these personnel are used to fill vacancies that do occur. Even though some courses may be canceled, nevertheless that backlog that seems to exist in the Federal community is used to support the cancellations and meet the vacancies that occur in our classroom.

FISCAL YEAR 1981 WHITE COLLAR CRIME SEMINAR PROJECTIONS

Senator CHILES. I note that you are talking about your white collar course and you look for it to go from 680 in 1980 to 180 in 1981. I know there is a backlog that we have talked about, but that seems like a drastic reduction. You would only have 180 enrolled in 1981?

Mr. **Brandstatter.** No, sir. We have trained, at the end of March 1980, a total of 611 people. The workload that is projected for 1981 is 560 at this time. But that figure changes constantly. We have trained 351 this fiscal year, and we have 444 more people remaining to be trained this year based on projections that have been made to us.

CENTER WORKLOAD

Senator **Chiles.** The Department estimates that there are going to be 16,346 student weeks of training in fiscal year 1980 but 13,320 in fiscal year 1981. That is a reduction of 19 percent. What is the reason for the declining trend in the student weeks of training?

Mr. **McKinley.** I am not really sure I understand where those numbers are coming from because both fiscal years would have funded student weeks of approximately 27,300 based on the submissions. It must relate to either basic training or special——

Senator **Chiles.** I will submit that question for the record so you can understand it, and we will show you where we got that information. We may have a couple other questions for the record.

We thank you.

Mr. **Davis.** Thank you very much, Senator.

[The information follows:]

ADDITIONAL COMMITTEE QUESTIONS

CENTER ENROLLMENT

Q. The Department estimates there is to be 16,346 student-weeks of training in fiscal year 1980 and 13,320 in fiscal year 1981, or a reduction of 19 percent. What is the reason for this declining trend in student-weeks of training?

A. The figures cited in the question relate to Center integrated basic training programs only. This reduction relates primarily to the fact that the Center, during fiscal year 1980, will eliminate a backlog in training requirements for the U.S. Border Patrol which involves a basic 16-week training course.

The Center is projecting an overall growth trend as indicated:

	Actual		Estimate*	
Fiscal Year	1978	1979	1980	1981
Student Weeks	36,983	36,348	39,882	41,565

*Estimate based on agency projections as adjusted by actual training conducted. Historically, agency projections tend to be overstated as compared to actual training conducted.

This projected growth is attributable to participating organizations which have transferred their training to Glynco, such as Immigration and Naturalization Service (1977), U.S. Border Patrol (1977), GSA Federal Protective Service (1977), and U.S. Customs Service (1979), as well as increased training activity in Advanced, In-Service, Refresher and Specialized (AIRS) training.

TRAINING CENTER NEEDS TO ACCOMMODATE THE INSPECTORS GENERAL

Q. How big is the current backlog for White Collar Crime courses?

A. The Center has trained 351 students during fiscal year 1980, through March 31. We plan to train an additional 444 students in this program during fiscal year 1980. This is a very popular course and it is difficult to measure or estimate the demand and/or backlog as additional requests continue to be received from organizations who learn about the availability of the course. It is anticipated that all demands for this course in fiscal year 1980 will be met.

We currently are projecting a workload of 560 students for fiscal year 1981, an increase of 380 over the 180 reflected in our fiscal year 1981 budget submission. This revised level should adequately meet the requirements for this program as we know them at this time.

Q. How big was the backlog a year ago?

A. At this time one year ago we had a backlog of about 800 students based on estimates received from the agencies. We expect to train 795 students in this program during fiscal year 1980.

Q. What additional resources are needed to accommodate the backlog?

A. The fiscal year 1980 White Collar Crime program was funded in our budget. The fiscal year 1981 budget reflects this training as reimbursable for an estimated 180 students. As was mentioned earlier, this is a popular program and we continue to receive additional requests for this training. We are currently planning to conduct 14 classes for a total student throughput of 560, all on a reimbursable basis. The current cost of this two-week program is $275. In addition, the agencies pay all transportation costs for their students.

If the White Collar Crime program were to be fully funded by the Center, additional funding would be required as follows:

Meals, Lodging and Training Materials ($275 x 560)	$154,000
Transportation and Enroute Per Deim ($310 x 560)	454,000
Total Resource Requirement	$608,000

FUNDING OF BASIC AND ADVANCED, IN-SERVICE, REFRESHER AND SPECIALIZED (AIRS)

Q. If the Center were funded so that it could pay 100 percent of the training costs for both basic and advanced training, how much in additional resources would be required?

A. The cost for full funding of both Basic and AIRS training projections in FY 1981 is summarized as follows:

Program	Cost Per Student-Week	Student Weeks	$ Amount
Basic Training	$491	25,266	$12,400,000
AIRS	$333	16,299	5,440,000
TOTAL Projections		41,565	17,840,000
FY 1981 Budget Request		27,300	13,400,000
Additional Funding Requirements		14,265	$ 4,440,000

FUNDING REQUIREMENTS FOR THE TRAINING NEEDS OF INSPECTORS GENERAL

Q. Mr. Davis testified that additional funding requirements will be needed for the Center in order to accommodate the training needs of Inspectors General. How much in additional funds will be required?

A. In March 1980, a report was published by the Office of Personnel Management which provides a profile of the job tasks and training requirements of auditors and investigators in the Offices of the Inspector General (IG). This report is now under study by each of the IG organizations and by the Center.

Following our assessment, the Center will be prepared to participate with the IGs in developing a core training model which will provide quality training to the widest range of personnel in an efficient and economical manner.

At this time, it is not possible to determine the potential costs and staff resources required to accommodate the IGs' needs; however, if the Center's workload is significantly increased, the Center will require additional funding and staffing as currently available resources have been programmed and allocated to meet previously known training requirements.

Based on current cost factors, it costs the Center $491 per student-week for basic training programs. This would also include the cost of student travel. Therefore, if the IG requirements would add an additional workload equivalent to an average resident student population (ARSP) of 50, this would convert to 2,600 student-weeks. Two thousand six hundred student-weeks would require additional funds of $1.25 million to staff and fund the program. This workload would require an estimated four additional staff members for instruction and support. The student throughput for this 50 ARSP would depend on the length of the course.

U.S. SECRET SERVICE

STATEMENT OF H. STUART KNIGHT, DIRECTOR

ACCOMPANIED BY:

- RICHARD J. DAVIS, ASSISTANT SECRETARY, ENFORCEMENT AND OPERATIONS
- MYRON I. WEINSTEIN, DEPUTY DIRECTOR
- ROBERT E. POWIS, ASSISTANT DIRECTOR, INVESTIGATIONS
- JOHN R. SIMPSON, ASSISTANT DIRECTOR, PROTECTIVE OPERATIONS
- ROBERT R. BURKE, ASSISTANT DIRECTOR, PROTECTIVE RESEARCH
- FREDERICK N. WHITE, JR., ASSISTANT DIRECTOR, ADMINISTRATION
- JOHN J. GIUFFRE, DEPUTY ASSISTANT DIRECTOR, ADMINISTRATION
- FRANK PALMER, CHIEF, FINANCIAL MANAGEMENT DIVISION
- ARTHUR D. KALLEN, DIRECTOR, OFFICE OF BUDGET AND PROGRAM ANALYSIS, DEPARTMENT OF THE TREASURY

PREPARED STATEMENTS

Senator CHILES. The committee will now receive testimony from the U.S. Secret Service regarding the fiscal year 1981 budget request and the 1980 supplemental request.

We are pleased to have Mr. Davis and Mr. Stuart Knight, Director of the Service, with us.

Your statements in full will be included in the record.

[The statements follow:]

STATEMENT OF RICHARD J. DAVIS

I appreciate the opportunity to appear before you in support of the supplemental appropriation request of the United States Secret Service for fiscal year 1980 as well as the annual budget request for fiscal year 1981.

Supplemental Request

The supplemental appropriation request for fiscal year 1980 is $20,650,000. Of this amount $7,100,000 is to fund pay increases which were effective October 7, 1979, and $13,550,000 for program increases. The program increases consist of the following: increased costs of operational travel for protection of non-campaign related permanent and temporary protectees, $2,275,000; increased scope and duration of Candidate and Nominee protection, $8,525,000; and, increased reimbursements to State and local governments, $2,750,000.

The supplemental request for the Candidate/Nominee program is required because of the determination made on the advice of the Advisory Committee to begin protection before March 1 and an increase in the scope of campaign activity. It is always difficult to determine precisely how much will be spent in this program, but, as you know, we are committed to returning any unused Candidate/Nominee funds to the General Fund.

We are also requesting additional funds to reimburse State and local governments for expenditures they make to meet extraordinary protective needs at missions to international organizations and in connection with visits of foreign dignitaries. At the beginning of this fiscal year, there was $6.3 million available for that purpose, an amount accumulated over a number of years. This year, however, has already imposed numerous extraordinary protective obligations on the City of New York, including, among others, the visits of Fidel Castro and Pope John Paul II to the United Nations. As of today, we have received bills from the City of New York totaling $6.8 million; bills are expected in response to retroactive changes in our regulations; and a bill of an as yet undetermined amount for additional expenditures in connection with the recently completed United Nations General Assembly will also be sent.

Recent events have demonstrated, unfortunately, the vulnerability of diplomatic facilities to attack. In this atmosphere we believe it important that the United States continue to make a maximum effort to protect such facilities in this country. To accomplish this important national interest, the federal government relies very heavily on the Police Department of the City of New York. They provide protection not only for the U.N., but fixed posts at numerous missions. It is to reimburse them for these activities, as well as to deal with other visits falling within the statute, to the extent allowed by law, that we are requesting a $2.75 million supplemental.

Budget Request

The request for fiscal year 1981 as amended by the President's revisions March 1980 is $157,041,000, a decrease of $20,609,000 under the proposed authorized level for fiscal year 1980. This reduction is due primarily to the increase in fiscal year 1980 to accommodate the Candidate/Nominee program. This level allows increases necessary to maintain programs at current operational levels. It also includes $350,000 for technical security support of protective operations.

Protective activities remain the number one priority of the Secret Service. The protective responsibilities of the Secret Service have been significantly heightened during fiscal year

1980 due to the Candidate/Nominee program. These responsibilities will continue through the inauguration in January 1981. While travel is increased extensively during the Campaign year, we also are finding that the trend is for our permanent protectees as well as foreign dignitaries visiting the United States, to travel more. This trend, which we cannot control, creates enormous budgetary pressures on the Secret Service which are exacerbated by the increased costs of travel.

Another factor contributing to increased protective activities has been the increased number of visits of foreign heads of state visiting this country. The unprecedented visits of President Fidel Castro of Cuba and Pope John Paul II earlier this fiscal year called for extraordinary protective measures. Funds to meet these kinds of foreign dignitaries as well as at missions to international organizations are vital in order to provide adequate security--particularly in New York--for these individuals and facilities in fiscal year 1981. Local authorities play a critical role in assisting the United States in meeting its obligations to provide this protection. We are thus seeking $3.5 million for reimbursement to local governments for this purpose.

With regard to the criminal investigative responsibilities of the Service, workload in check forgeries decreased in fiscal year 1979 due to a drop in check cases referred to the Service. An analysis of the reasons for this decreased referral was undertaken by the Service jointly with the Bureau of Government Financial Operations and the administrative problems spotted as the cause are being addressed.

During fiscal year 1979, the Secret Service took aggressive action in suppressing the circulation of counterfeit currency. Through its investigative efforts in this area, the Service traced the origin of 20 percent of counterfeit notes passed on the United States public to Colombia, South America. The Service is participating in a task force working with Colombian authorities to improve their detection and investigation of counterfeit U.S. currency.

In closing, I would like to thank this Subcommittee for providing the resources necessary for the Secret Service to carry out its mission. Director Knight will now add to my comments. After that, we will be pleased to answer any questions you or other members of the Committee may have.

STATEMENT OF H. S. KNIGHT

Mr. Chairman, I am pleased to appear before you and the other members of this committee to present the fiscal year 1980 supplemental appropriation request as well as the annual appropriation request of the United States Secret Service and to report on our activities during the current and past fiscal years.

Introduction of Associates

With me today, Mr. Chairman, is the Deputy Director, Mr. Weinstein; Mr. Powis, the Assistant Director for Investigations; Mr. Simpson, the Assistant Director for Protective Operations; Mr. Burke, the Assistant Director for Protective Research; Mr. White, the Assistant Director for Administration; Mr. Giuffre the Deputy Assistant Director for Administration; and Mr. Palmer, the Chief of our Financial Management Division. Since this is the first appearance before this committee of Mr. Simpson, Mr. White, and Mr. Giuffre, with your permission, I would like to insert a short biographical sketch of each for the record.

JOHN R. SIMPSON
Assistant Director - Protective Operations
United States Secret Service

John R. Simpson was born February 13, 1932, in Boston, Massachusetts. He received a bachelor of commerce degree from Loyola College in 1954. Immediately following completion of his baccalaurate degree, he served in the United States Army for two years. In 1963, he received an LLB degree from Portia Law School.

Mr. Simpson was appointed a Special Agent of the United States Secret Service in 1962 and assigned to the Boston Field Office. Subsequently, he was transferred to the Presidential Protective Division in Washington, D. C. During his career he has served as Assistant Special Agent in Charge of the Protective Support Division, Deputy Special Agent in Charge of the Vice Presidential Protective Division, Special Agent in Charge of the Foreign Missions Division (Uniformed Division), Special Agent in Charge of the Dignitary Protective Division, Inspector in Washington. D.C. (Inspector in Charge of Candidate/Nominee Protective Division 1976 Campaign), Special Agent in Charge of the Presidential Protective Division, and as Deputy Assistant Director for the Office of Protective Operations (Uniformed Division).

On August 26, 1979, he was promoted to Assistant Director, Office of Protective Operations. In this capacity, he is responsible for administering the physical protective mission of the United States Secret Service.

During his career, Mr. Simpson has participated in several major management training programs; most notably, the National War College and the Federal Executive Institute, Charlottesville, Virginia.

Mr. Simpson is a member of the International Association of Chiefs of Police. He is married to the former Geraldine H. Teehan of Boston, Massachusetts. They have two children and reside in Bowie, Maryland.

FREDERICK N. WHITE, JR.
Assistant Director - Administration
United States Secret Service

Frederick N. White, Jr. was born August 11, 1935 in Philadelphia, Pennsylvania. He received a Bachelor of Science degree in industrial and business management from Temple University in 1958.

Following his academic career, Mr. White began his professional career as a systems analyst with an insurance company. He also worked as a computer system analyst and project manager with several companies in the scientific and technical information field.

In July 1967, Mr. White began his federal career with the United States Coast Guard, Department of Transportation. He served in various capacities with the Coast Guard until April 1970 when he was appointed Chief, Mission Support Section, Information Systems Division.

In August 1974, Mr. White was appointed to the position of Assistant Director for Administration of the United States Fish and Wildlife Service, Department of the Interior. In that capacity, Mr. White was responsible for a wide variety of support services including personnel, safety and security, finance and accounting contracting and general services, automatic data processing, correspondence management, publications, and for insuring that the United States Fish and Wildlife Service complied with all legal, regulatory and policy requirements in conducting its work.

Mr. White was appointed Assistant Director, Office of Administration, United States Secret Service in January 1980.

During his career, Mr. White has participated in several major management training programs; most notably, the Program for Senior Managers in Government, Harvard University, 1979; the Conference for Senior Executives on Public Policy Issues, Brookings Institution, 1978; Congressional Operations Seminar for Managers, 1978; the Federal Executive Institute, Charlottesville, Virginia, 1976; and an Executive Development Seminar Management of Organizations, Oak Ridge, Tennessee, 1972.

Mr. White is married to the former Joan N. Scharas of Philadelphia, Pennsylvania. They have two daughters and reside in Rockville, Maryland.

JOHN J. GIUFFRE
Deputy Assistant Director - Administration
United States Secret Service

John J. Giuffre was born December 28, 1934, in New York City, New York. He received a Bachelor of Arts degree in police administration from Indiana University in 1957. Immediately following completion of his baccalurate degree, he served in the United States Army Military Police Corps for two years. In 1975, he received an M.A. degree in legal studies from Sangamon State University.

Mr. Giuffre was appointed a Special Agent of the United States Secret Service in 1959 and assigned to the Indianapolis Field Office. Subsequently, he was transferred to the Presidential Protective Division in Washington, D.C. During his career he has served as Assistant to the Special Agent in Charge of the Vice Presidential Protective Division, and Assistant Special Agent in Charge of the New Orleans Field Office. As the Special Agent in Charge of the Springfield Field Office, he was responsible for the investigative and protective activities for the United States Secret Service in the Springfield, Illinois area. He also held the position of Assistant Special Agent in Charge of the Chicago Field Office.

Mr. Giuffre was appointed to the position of Deputy Assistant Director, Office of Administration, United States Secret Service in 1979.

Mr. Giuffre is married to the former Phyllis Livorno of Madison, Indiana. They have two sons and reside in Vienna, Virginia.

Supplemental Request

The Secret Service is requesting a supplemental appropriation for fiscal year 1980 of $20,650,000. Funds to cover comparability pay increases effective October 7, 1979, in the amount of $7,100,000 are included, however they will be addressed separately by the Director of the Office of Budget and Program Analysis of the Department of the Treasury.

Out of the total program request of $13,550,000, funds in the amount of $2,275,000 are required to partially offset the increased costs of non-Campaign-related protective travel, while the sum of $8,525,000 is needed to cover the increased scope and duration of Candidate and Nominee operations resulting from the early initiation of Candidate protection. The remaining $2,750,000 is necessary for reimbursements to State and local governments in accordance with Public Law 94-196 under the broadened interpretation of those reimbursements enacted in the Treasury Department Appropriation Act, 1980.

We are confronted with escalating costs in the area of permanent protective travel resulting primarily from the increased mobility of our protectees and rapidly rising prices. These factors have produced expenses that were not included when our fiscal year 1980 budget was prepared, and which must be provided for in order to maintain the necessary level of protection for our permanent protectees.

The funds requested for Candidate and Nominee protection in our original fiscal year 1980 budget request were based on a starting date for Candidate protection no earlier than March 1, 1980. On advice of the Advisory Committee on Candidate Protection, however, protection under law began with one Candidate on October 25, 1979, another on November 13 and others beginning on January 11, 1980. In urging us to begin at this time the Committee members were aware that this would necessitate a supplemental appropriation request to fund the extended protective operation. These funds are needed to sustain the pace of Campaign protective operations through the balance of the fiscal year.

Public Law 94-196 defines those protective activities in cases of extraordinary need for which State and local governments may seek reimbursement. In this year, largely due to the extraordinary difficult international situation and the presence of visitors to the U.N. requiring truly special protection, the amounts needed for this purpose will exceed those already budgeted.

Budget Request

The pending appropriation request for fiscal year 1981 totals $157,041,000, a decrease of $20,609,000 under the proposed authorized level for fiscal year 1980. Of this decrease the sum of $18,409,000 is a function of the inclusion of substantial funds for the Candidate/Nominee program in the fiscal year 1980 budget, while the remaining $2,200,000 represents additional reductions reflecting the President's desire to balance the fiscal year 1981 budget. However, funds have been included in the request for mandatory and other increases necessary to maintain current operational levels. The Service is also requesting $350,000 for technical security support of our protective operations. The President's additional reductions to balance the budget were decided upon after the Secret Service budget was submitted to Congress, and are not reflected in the justification materials that were provided at that time.

Continued Increase in Activities

The activities of the Secret Service have continued to expand in the past year. Travel by permanent protectees of the Service reached an unprecedented level. . At the same time, several major diplomatic events occurred resulting in extended periods of protection provided foreign dignitaries visiting this country.

Protective Effort

Our protective responsibilities continue to receive our highest priority. The Service is fully committed to providing a safe and secure environment for those persons whom we protect. To this end we are constantly evaluating new equipment and methods to assist us in fulfilling this mission in an effective and unobtrusive manner.

The past year was a period in which enormous strain was placed upon our personnel and other resources. In addition to extraordinary protective efforts associated with our ongoing permanent protective responsibilities, temporary details were established for the 34th General Assembly of the United Nations, the visit to the United States by Vice Premiers Deng Xiaoping and Fang Yi of the People's Republic of China in January and February, the visit to the United States by Pope John Paul II, and the visit of Premier Fidel Castro of Cuba. Moreover, the problems associated with worldwide terrorism and international conflict continued to require extra security measures in all areas of our protective responsibilities.

In terms of our ability to accomplish our protective and investigative mission, this past year has been a period of awesome responsibility and has required great sacrifice on the part of our entire staff. Extraordinary demands for manpower have been met primarily through the assignment of extended periods of overtime. To continue in this vein results in declining morale and efficiency and we have initiated programs to try to deal with this problem. At this time, I would like to commend the men and women of the Secret Service who have given so unselfishly toward the successful accomplishment of our mission.

Candidate and Nominee Protection

This fiscal year finds the Service dedicating a major portion of its resources toward candidate and nominee protection. Funds for this initiative were programmed based upon a start-up date for protection of March 1, 1980.

However, at the direction of the Secretary of the Treasury, protection commenced for Senator Edward M. Kennedy on September 9, 1979. The Advisory Committee recommended on October 25, 1979 that this protection be continued. Upon the recommendation of the Advisory Committee, the Service commenced protection for Mr. Ronald Reagan on November 13, 1979. The protection for all other candidates meeting the guideline requirements as set by the Advisory Committee commenced January 11, 1980. At that time details were assigned to Senator Howard H. Baker, Jr. and Congressman Philip Crane. Since then, protection was discontinued for Senator Baker on March 5, 1980 and Congressman Crane on April 3, 1980 with their official withdrawals from the campaign. Protection commenced for John B. Anderson on March 10, 1980 and for George Bush on March 17, 1980.

As you know, the accelerated start-up date has required the Service to seek supplemental funds in order that we do not exhaust already taxed resources. The need for additional funds was acknowledged in meetings held with the Advisory Committee when it was decided that circumstances warranted immediate protection for those candidates I mentioned previously.

Assistance of Other Federal, State and Local Law Enforcement Agencies

Each year, the Service relies heavily on the assistance and cooperation of local, state and Federal law enforcement agencies to ensure the maximum security for our protectees. This will be especially true during the 1980 Campaign. Without their support, our effectiveness would be seriously impeded. It should be noted that as a result of budgetary constraints, there have been instances where state and local agencies have been unable to fulfill our request for assistance.

Protection of Foreign Dignitaries

Fiscal Year 1979 continued the high level of foreign dignitary travel experienced in fiscal year 1978. In conjunction with these visits, the Secret Service provided security for 115 visiting foreign dignitaries. Of the 115 visits, 111 involved a head of a foreign state or government while 4 involved other distinguished visitors to the United States. The average stay for these visiting foreign dignitaries was 5.4 days. During September and October, the Secret Service provided protection for 21 foreign dignitaries visiting the United Nations 34th General Assembly.

Among the official representatives requiring extraordinary protective measures was Premier Castro of Cuba who visited the United States from October 11 through October 14, 1979. The security arrangements provided for Pope John Paul II, whose visit spanned a period of 7 days, from October 1 through October 7, 1979 and five major cities added a new dimension to protection provided a visiting foreign dignitary.

The protection provided Pope John Paul II represents the largest protective effort for a single foreign dignitary in the history of the Secret Service. In terms of manpower requirements and logistical demands, the magnitude of the event was unprecedented. As I mentioned previously, the Service was protecting a multitude of individuals during this same time frame. As a result of these demands, manpower needs could only be met through the use of 16-hour shifts, and the suspension of days off.

The responsibilities of the men and women assigned to this program included coordinating the efforts of some 38,000 uniformed units including local and state law enforcement personnel and national guardsmen engaged in controlling record crowds.

Again, I would like to express my appreciation to those men and women of the Secret Service who performed in an outstanding manner and contributed markedly to the success of the Pope's visit.

In March 1979, the Secret Service provided protection for the visit of President Sadat of Egypt and Prime Minister Begin of Israel which culminated in the signing of the Mid-East Peace Accord.

During the current year, as of March, 25, 1980, the Service has provided protection for 33 foreign dignitaries visiting the United States, all of which were heads of a foreign state or government. In September, protection will once again be afforded a large representation of foreign dignitaries who will be attending the 35th Session of the United Nations in New York City.

The protection of foreign dignitaries continues to be an important facet of the Secret Service protective mission. The protection of these travelling dignitaries is particularly critical given the prevailing climate of terrorism in the world today. The avowed intention of some organizations to pursue their goals through assassination, kidnapping, or other forms of violent terrorism, in deliberate attempts to disrupt diplomatic exchanges, has made it necessary for the Service to redistribute scarce resources to provide security arrangements. With the concern over the Middle East situation, the complex diplomatic problems confronting us around the world and world-wide interest in the resolution of various disputes, we are anticipating a continuation of the large numbers of foreign dignitaries visiting our country.

Presidential Protection

Above average demands were placed upon the manpower and logistical resources of the Secret Service in providing Presidential Protection during fiscal year 1979. Contributing to this were Presidential visits to the Economic Summit, French West Indies, in January; the State visit to Mexico, in February; the Middle East Peace Mission to Egypt and Israel, in March; the SALT II Summit, Vienna, Austria, in June; and the Economic Summit to Japan and Korea in June.

Other Protection

Also, in fiscal year 1979, the activities of Former Presidents and the widows of Former Presidents remained at high levels. Expanded travel schedules required additional resources to ensure security for those receiving Secret Service protection.

U. S. Secret Service Uniformed Division

The U. S. Secret Service Uniformed Division provides security for the Executive Residence and grounds, the protection of the temporary official residence of the Vice President and grounds, and any building in which Presidential offices are located.

In addition to providing protection to the White House, the Secret Service Uniformed Division also provides security coverage for four hundred and eight diplomatic missions located in the metropolitan area of-fror District of Columbia on an as-needed basis.

Protection was also provided on an as-needed basis to foreign missions outside of the Washington, D.C. area in fiscal year 1979 and continues as a result of the current diplomatic climate.

The size of the Uniformed Division of the Secret Service has been reduced. As a result, it has been necessary to utilize excessive amounts of overtime in our effort to ensure adequate security in the diplomatic community. However, the demands upon our personnel are unyielding and I do not know how long this effort can be maintained. The excessive overtime we have been requiring not only strains available resources but results in stress problems, health problems and morale problems. In order to stem an unacceptable attrition rate, it will be necessary in the future to reduce the amount of overtime required which can only have a deleterious affect on security provided foreign missions in the greater Metropolitan area. This is unfortunate given the tense diplomatic climate in existence today.

In spite of these conditions the Uniformed Division has been highly effective and has been playing an increasing role as a vital, integral part of the security coverage afforded our protectees. I am tremendously proud of their outstanding contribution to the overall effectiveness of the operations of the U. S. Secret Service.

Treasury Security Force

The Treasury Security Force is responsible for the protection of life and property at the Main Treasury Building and the Treasury Annex in Washington.

In addition to their regular duties, they provide security for the Securities Transactions Room, handling large crowds of people who come to purchase Treasury Notes. Formerly a once-a-week occurrence, this type of security is now needed almost daily. Treasury Security Force Officers also man surveillance posts during ceremonies at the White House and grounds, provide security in the exhibit halls in the Main Treasury Building, and provide protection for the large amounts of cash and securities stored in the vaults.

During 1979, the force was reduced 20 positions. With the emplacement of additional electronic devices and the closing of some entrances, we have tried to achieve a minimal loss of security.

Field Offices

The field offices are the backbone of our investigative operations, being the point from which the investigation of all cases, criminal and noncriminal, is initiated. In addition, the Service draws heavily on the Special Agents permanently assigned to the field offices for temporary protective assignments. The ability to use field office agents was particularly important, for example, during the President's Mississippi River Trip.

In the face of increasing amounts of travel out of district to augment temporary protective details, the Special Agents operating out of our field offices were able to sustain a credible investigative effort. The high level of arrest and conviction activity during fiscal year 1979 is exemplary and is an excellent indicator of the dedication and effectiveness of our Special Agents in the field.

Overall Investigative Caseload

The past year has proven to be very demanding in the area of criminal investigations. Total cases received decreased from about 160,000 in fiscal year 1978 to around 128,000 in fiscal year 1979. However, the Service sustained a high level of investigative activity, and made a significant contribution toward reducing our overall pending caseload.

During the fiscal year 1979 the pending caseload was reduced from 70,000 at the end of fiscal year 1978 to about 54,000 cases at the end of fiscal year 1979.

This extraordinary investigative effort was essential in order that we might be adequately prepared to assume our Campaign responsibilities this year without seriously undermining the investigative and law enforcement functions of the Service.

The following chart shows the total cases received for investigation over the last five years, as well as the most recent estimate of the number of cases that will be received in fiscal years 1980 and 1981. (Chart A)

Counterfeiting Activities

During fiscal year 1979, the Secret Service recovered $50.7 million in counterfeit currency. Of this amount, $46.3 million, or 91 percent was seized before circulation. The balance of $4.5 million was passed on the public, an increase of 13 percent from the $4 million of the previous year.

The amount of counterfeit currency recovered represents the greatest quantity of counterfeit currency ever seized by this Service, a 127 percent increase over the amount recovered in fiscal year 1978.

In the course of fiscal year 1979, sixty-three counterfeit plants were suppressed by the Secret Service within the United States. This figure compares favorably with the total of fifty-one suppressed in fiscal year 1978.

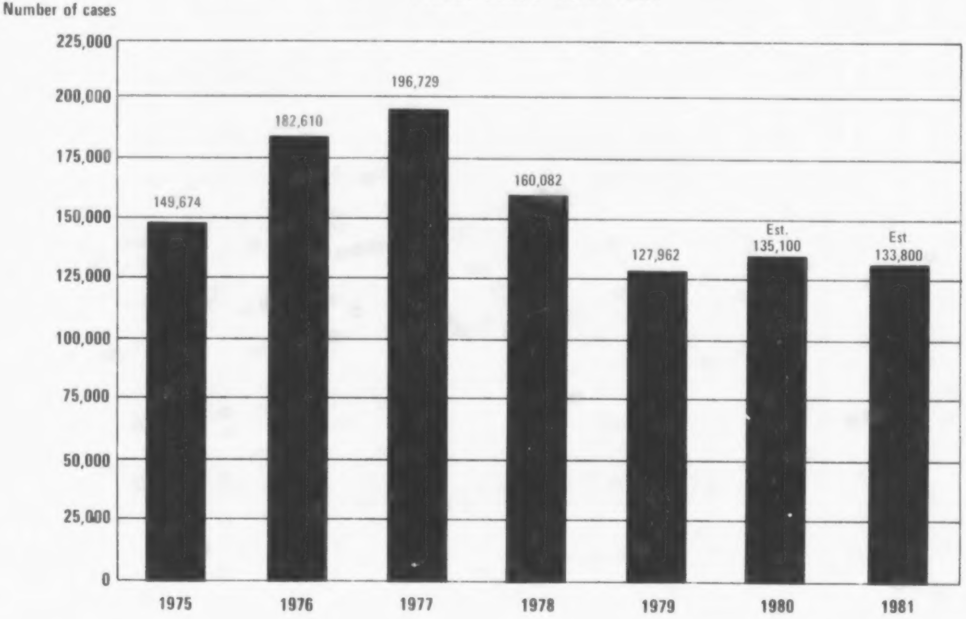
Of the $4.5 million passed on the American public, 20 percent of the notes were traceable to origins in Colombia, South America. To combat the increasing impact of this situation, a task force of Special Agents was sent to Colombia to assist local authorities in the investigation of counterfeiting of U. S. currency in that country. From January 5, 1979, through July 12, 1979, this

CHART A

United States Secret Service

TOTAL CASES RECEIVED FOR INVESTIGATION

Fiscal Years 1975 -1981



task force was responsible for the seizure of an additional $8.3 million in counterfeit U. S. currency above the $50.7 million I mentioned previously.

In the past year, a tri-nation committee was initiated consisting of the Federal Reserve Board, the Bureau of Engraving and Printing, and the Secret Service, of the United States; the Bank of England; and the Bank of Canada. Most recently, the Bank of Australia has joined the committee. This committee has the task of studying the potential compromise of their respective genuine currencies through the use of the newly developed color copier machines. The Secret Service was invited to join this committee to provide assistance from our expertise in the field of counterfeit detection.

The statistical data available for the first month of fiscal year 1980 shows the trend of increased activity from fiscal year 1979 continuing into the new year. During this period, a total of $4.1 million in counterfeit currency was recovered with $3.7 million or 90 percent being seized before circulation.

A continued effort in fiscal year 1980 is the aggressive investigation of counterfeiting operations in Colombia, South America. Our presence there has shown a marked improvement in the manner and technique by which Colombian authorities investigate these cases.

The following charts show for fiscal year 1973 through 1979 the dollar value of counterfeit notes seized before circulation, with the overall losses to the public and for fiscal year 1972 through 1979 the number and dollar value of the counterfeit notes passed. (Charts B and C)

Check Forgery

Forgery of Government checks continues to be a significant area of enforcement activity for the Secret Service. During fiscal year 1979, approximately 65,000 check cases were received for investigation, a decrease of about 28,000 cases from fiscal

CHART B

United States Secret Service
COUNTERFEITING ACTIVITY
Fiscal Years 1973 - 1979

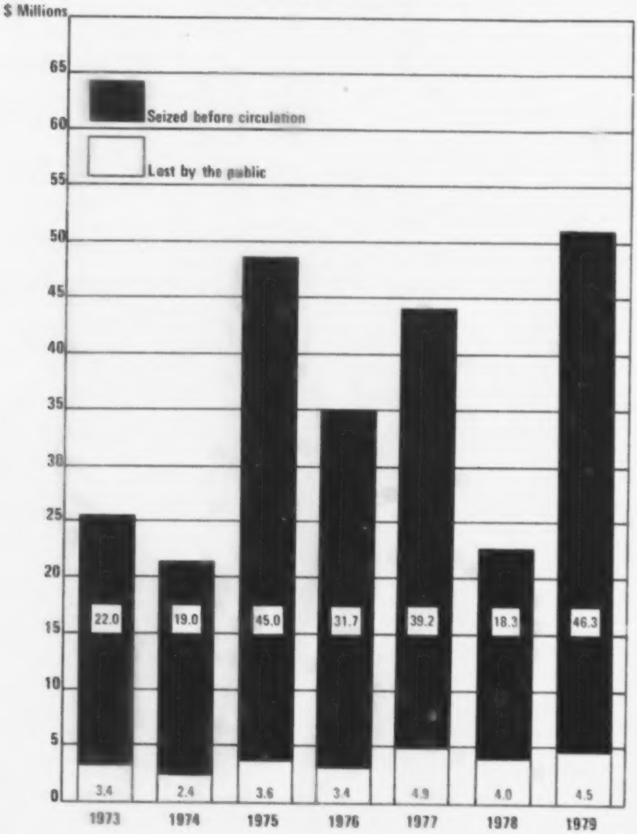
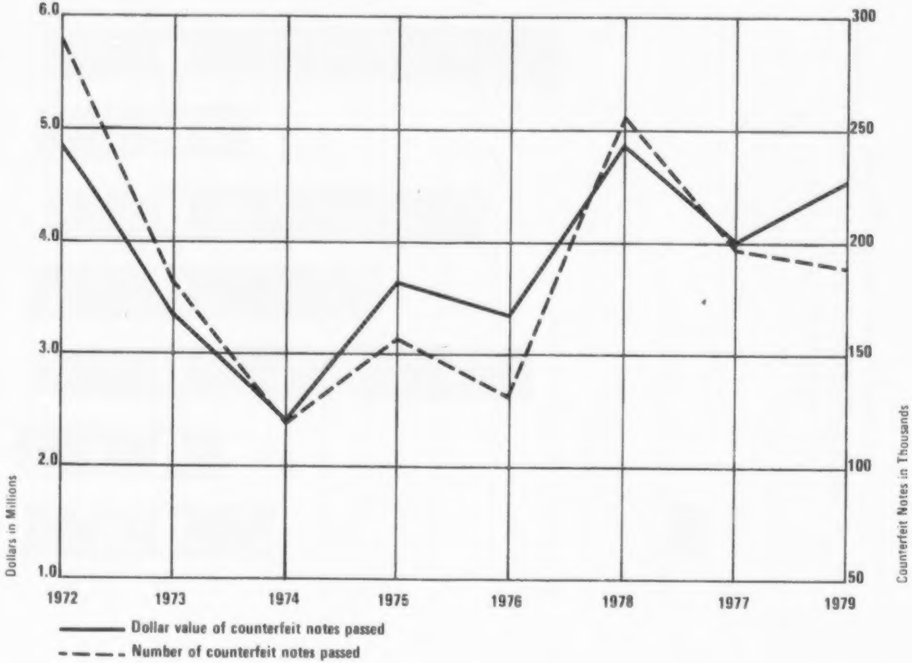


CHART C

United States Secret Service
COUNTERFEITING TRENDS
Fiscal Years 1972 - 1979



r 1978. For fiscal years 1980 and 1981, based on a straight
e projection, we are also anticipating referrals of 65,000
es. During the past fiscal year, the Secret Service made 6,500
ests in check forgery cases, a reduction of about 31 percent
m the arrest activity in fiscal year 1978 of 9,400 arrests.

The following chart reflects the number of check cases received
investigation for fiscal years 1975 through 1979 with estimated
bers to be received in fiscal years 1980 and 1981. (Chart D)

Bond Forgery

During fiscal year 1979 the total number of bond referral
ses to the Service decreased from about 11,000 cases in 1978
about 10,000 cases in fiscal year 1979. More stolen bonds are
ng recovered before they are forged, thereby reducing the
ber of bonds which appear as forgery referrals at a later
e. Arrests for the same period also decreased slightly, from
to 133 by the end of fiscal year 1979.

The following chart shows the number of bond forgery cases
eived for investigation during fiscal years 1975 through 1979
h the estimated number of cases for fiscal years 1980 and
1. (Chart E)

Organized Crime

The Secret Service has continued to participate in the Organized
me Program of the Department of Justice. Experienced Special
nts of this Service are assigned to the various strike forces
und the country. The fourteen organized crime strike force
resentatives are provided additional support by the various
ld offices and headquarters as needed.

The Secret Service is an active member of the National
anized Crime Planning Council, which consists of members of
eral law enforcement agencies. The council visits the strike
ces and gathers criminal intelligence information concerning
anized crime interests.

United States Secret Service

CHART D

NUMBER OF FORGED CHECK CASES RECEIVED FOR INVESTIGATION

Fiscal Years 1975 - 1981

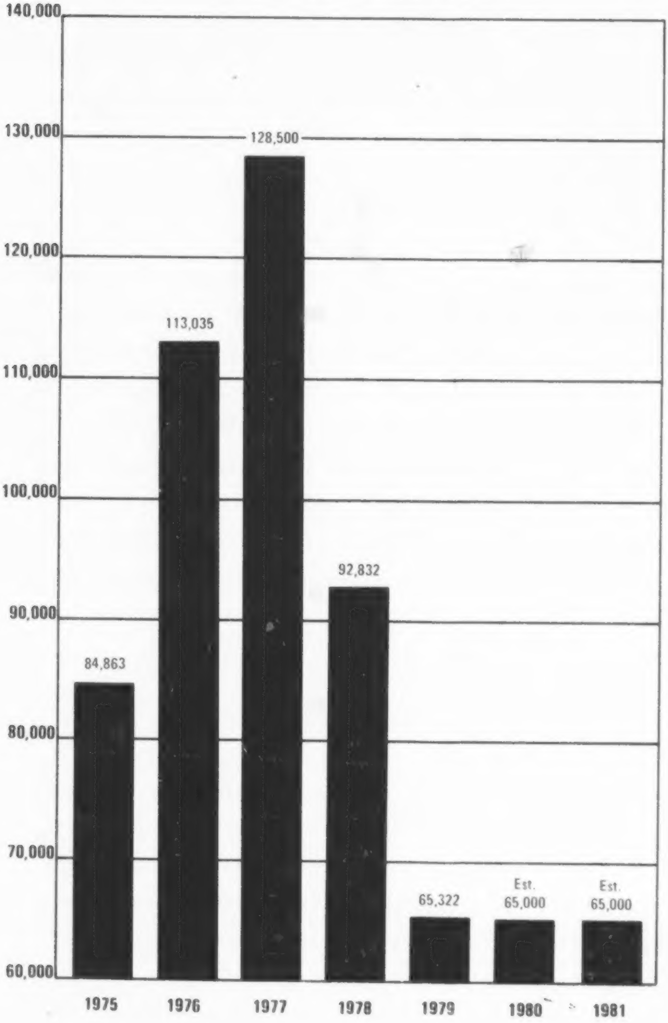
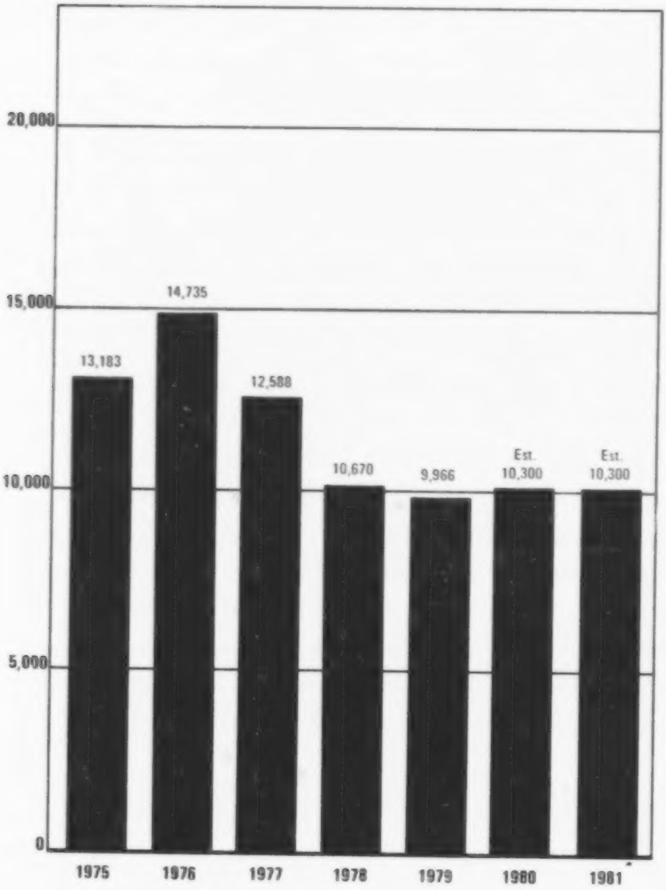


CHART E

United States Secret Service

NUMBER OF FORGED BOND CASES RECEIVED FOR INVESTIGATION

Fiscal Years 1975 - 1981



Visits by this council to the Strike Force Districts have renewed enthusiasm and interest in the program. Our strike force representatives report that inter-agency cooperation has improved and, as a result, criminal intelligence information that otherwise would not have been received has become available, proving beneficial to our investigative activities.

Equal Employment Opportunity

The Service has continued to pursue a vigorous program for the recruitment of qualified minority employees, as well as a program to prepare minority clerical and other non-professional employees for advancement into professional positions. As you know, the Service has a special need for minorities in the ranks of our Special Agents and uniformed officers. Accordingly, we have made significant recruitment efforts for these categories of personnel.

Despite these efforts, the Service has not had the opportunity to expand its minority employment program in the Special Agent positions to the extent we would like. However, the Service's minority employment increased approximately six percent during the fiscal year 1979 in spite of reductions taken in overall employment and the relatively low turnover rates in this category of employees. Moreover, there continues to be keen competition for qualified minorities on the part of private industry.

Freedom of Information and Privacy Acts

With the enactment of amendments to the Freedom of Information Act, the Service received a large number of requests from members of the public for records that we maintain.

During fiscal year 1979, the Service processed more requests than in any previous year, including 849 FOI requests and 142 Privacy Act Requests. In addition, the Office of Legal Counsel processed 68 FOI appeals while failing to sustain the Agency's position in only one case which went to litigation.

We had hoped that this litigation would decrease as the trend of the courts to accept the claimed exemptions and to sustain the Service's position became evident. However, this kind of litigation has continued to increase. The kinds of requests have become more diverse. These include inquiries concerning both law enforcement and administrative practices of the Service.

I would like to point out at this time, that since the passage of the Freedom of Information and Privacy Acts in 1974, the Service has spent from $200,000 to well in excess of $300,000 each year in responding to the numerous requests. Of this amount less than one-half of one percent is recoverable through FOI/Privacy Act billings. Moreover, less than twenty-five percent of this fraction is actually ever received from the individuals involved. As a result, since 1975, the Service has written off over $3,400 in uncollectable receivables and continues to bear the financial burden of these acts exclusively.

Protective Research

During the past fiscal year the Service has continued its efforts to improve methods for determining the potential danger of persons who make threats or who exhibit an unusual interest in persons whom we are authorized to protect. In this regard, a proposal concerning the definition of critical elements of human behavior was formalized late in fiscal year 1979 and is under consideration.

Our heavy involvement in Campaign '80 will significantly increase demands to identify threats to candidates and nominees and our operations will be dominated by that effort this year.

The Service, like other enforcement bodies, relies heavily on the public and other organizations for its intelligence data. We continue to suffer as a result of the FOI and Privacy Acts which we believe have severely reduced the availability of this information. As a result, greater amounts of resurces must be expended to ensure adequate security for protective functions and data regarding enforcement operation; resources which the Service can ill-afford.

Summary

In summary, Mr. Chairman, the workload and protective responsibilities of the Secret Service continued to expand and take on new dimension this past year. The additional demands of the Candidate and Nominee program will exacerbate the conflicting demands upon our resources this year. Fiscal Year 1981 will mark the culmination of this massive protective effort and the reallocation of resources to our investigative responsiblities.

The budget request before you contains only those amounts which are absolutely necessary for carrying out the programs for which the Service is responsible.

In this regard I am grateful to your Committee for the support given us over the years. Your support and understanding of our needs is very much appreciated by all of us in the Secret Service.

Mr. Chairman, this concludes my statement. I will be pleased to answer any questions you or the other members of the Committee may have.

1980 SUPPLEMENTAL REQUEST

Senator CHILES. Mr. Knight, I understand the Secret Service has requested a $20.7 million supplemental for 1980, with $8.6 million for the increased cost of candidate and nominee protection, $2.8 million for reimbursements for New York City, and $2.3 million for noncampaign travel costs.

I also understand that without this supplemental the Secret Service expects to run out of money by July. Is that correct?

Mr. KNIGHT. That is basically correct, Mr. Chairman.

Senator CHILES. What do you expect will happen if you don't receive additional appropriations?

Mr. KNIGHT. Well, we certainly can't close shop. I don't want to repeat last year's drastic reduction in services where we curtailed all criminal investigations except those of an emergency nature, canceled training, canceled trips, and fell behind in our communications.

Senator CHILES. The material given to us by the Department states hat the Service would exceed its budget by $17.7 million in 1980. Why s there a $20.7 million request?

Mr. KNIGHT. The difference between the two figures represents the unds requested for reimbursements to State and local governments.

Mr. DAVIS. Part of that is the reimbursement money, which should eally be viewed as a separate account because if we don't have the noney for reimbursement, we just wouldn't reimburse.

In terms of the Secret Service's operating accounts, I think it robably does face the fact that at some point it is going to run out of noney. Obviously if you know that now, that there is going to be no nore money, you try to do things to conserve funds including perhaps iring an awful lot of people. I am not sure what I would do and the Director would do when we woke up on that morning when the funds veren't there, because technically—more than technically—as a matter f law we should do nothing and nobody should show up.

TRAVEL LIMITATION

Senator CHILES. The 1980 travel budget for the Secret Service is $15.5 nillion, and because of section 501 of the Treasury, Postal Service ppropriations bill, that amount may not be exceeded without the pproval of the House and Senate Appropriations Committees.

Mr. Knight, the committee has your letter requesting the Secret Serve be authorized to exceed the $15.5 million already for 1980 travel osts. I understand the House has approved your request.

How much do you now estimate the Secret Service will need to pend for travel this fiscal year? How much has been spent to date?

Mr. WHITE. As of the end of February 1980, the Secret Service has bligated $6.3 million for travel and transportation of persons. On that asis, the Service expects to obligate approximately $22,151,000 for avel through the end of the fiscal year. In the absence of fiscal fundg, this would be a $6,582,000, travel deficiency.

Mr. DAVIS. Some of that is in the candidate and nominee program nd some is in the regular program.

Senator CHILES. How much has been spent to date?

Mr. WHITE. As of the end of February 1980, the Secret Service has obligated $6,336,000.

Mr. DAVIS. That was the end of February, Senator.

Senator CHILES. For the record, you had better give us those figures of why you think you are exceeding it. That would be about 45 percent of what your total is for the year. You ought to be able to give us a little better estimate now that we are into April. We would like to have a little more on that.

Mr. DAVIS. We would be happy to do that, Senator.

[The information follows:]

TRAVEL FUNDS

Question. How much has been obligated to date for travel?

Answer. Through March 31, 1980, the Secret Service had travel obligations of $8,007,000.

Question. Do you believe that the obligation rate for travel during the second half of this fiscal year will exceed the obligation rate during the first half? If so, why?

Answer. Based on projections and known occurences, the travel obligations for the second half of fiscal year 1980 will exceed those for the first half of fiscal year 1980. Much of the increase in the second half is attributable to the Presidential campaign. At this time, we anticipate there will be three presidential nominees eligible for Secret Service protection. Also, the three Vice-Presidential nominees and the spouses of Presidential and Vice-Presidential nominees are eligible for protection. This means that up to 12 individuals will be in travel status simultaneously.

Significant travel obligations will be incurred in relation to the protective operations at the Democratic and Republican national conventions and an anticipated third party convention. Because these are public events of great importance involving massive national exposure, a secure environment is necessary for the protectees. To achieve this, it will be necessary to bring in large numbers of special agents from various field offices throughout the country. In addition, previous campaign experience has shown that candidate travel picks up significantly immediately prior to the national conventions.

The United Nations General Assembly begins its 35th session in September. This has always brought about a significant increase in foreign dignitary travel. Dignitaries traveling to the United States for this event, usually continue their travel after stopping in New York. Significant travel obligations can be expected as a result of this.

NONCAMPAIGN TRAVEL COSTS

Senator CHILES. If the committee approves a reprograming for increased travel costs, will this eliminate the need for the requested supplemental for noncampaign travel costs?

Mr. KNIGHT. Mr. Chairman, I believe that reprograming authority would alleviate the immediate deficiency, but it would not eliminate the need for supplemental funds.

Senator CHILES. How much of the noncampaign travel costs are associated with the former Presidents and widows of former Presidents?

Mr. KNIGHT. We are asking for about $2¼ million in the supplemental for non-campaign related protective travel. As to the amounts ascribable to each individual, we can furnish that for the record.

Senator CHILES. All right, sir. I would like to know how much is associated with permanent protectees other than former Presidents, a breakdown on that.

Mr. KNIGHT. Yes, sir.

Senator CHILES. And how much would be associated with the temporary protectees and who they are.

Mr. KNIGHT. I think we recognize that you are focusing on a particular group. But I think it is also important to recognize that part of this travel request is for protection of foreign dignitaries, such as the 115 that we had last year and the 50 or 60 we have already experienced this year, including the Pope's and Fidel Castro's visits.

[The information follows:]

NONCAMPAIGN RELATED TRAVEL

Funds in the amount of $2,275,000 are required to meet the increased cost of operational travel for protection of our noncampaign-related permanent protectees. Amounts requested for permanent and temporary protection are as follows:

Permanent protection

Presidential	$200,000
Vice-Presidential	600,000
Increases in basic hotel rates	[1] 525,000
Cost differential between double and single rooms	[1] 400,000
Commercial trucking—armored vehicles	[1] 150,000
Subtotal	1,875,000

[1] Costs are spread throughout all protective categories.

Temporary protection

Visit of Pope John Paul II and Premier Castro	$200,000
Winter Olympics, Lake Placid	200,000
Subtotal	400,000
Total request for noncampaign related travel	2,275,000

USE OF MILITARY AIRCRAFT

Senator CHILES. The justification material refers to occupational safety considerations which preclude the use of military aircraft even when such aircraft are available. Describe what those occupational safety considerations are.

Mr. KNIGHT. We have done a survey on the aircraft that the Air Force has furnished us—or offered us, rather—and in our opinion it is not appropriate for our agents from a safety and health point to travel on them. We are working with the Air Force on this.

Because of our operating conditions, and the criteria we must meet, we think we should not utilize the aircraft we have been offered.

Senator CHILES. Is that because they are offering you some very low-grade aircraft?

Mr. KNIGHT. Primarily because the Air Force is offering us cargo aircraft as opposed to passenger aircraft. If our people travel in those aircraft, which we consider to be unsafe, they will not be effective under the conditions we expect them to function upon arrival. This constitutes not meeting our mission.

But as I say, we are continuing to discuss this with the Air Force. In the meantime we are not utilizing those aircraft.

Senator CHILES. We used to fly a lot of people in those aircraft overseas and put them into combat as soon as we got them there.

Mr. KNIGHT. Under quite different conditions, I suggest, than those under which our special agents are expected to function. I am not talking about first-class accommodations on commercial aircraft. But I would be happy to furnish you the results of the study and its findings, the reports we have received, and the experiences we have had, all of which demonstrate to me that it is not safe for us to transport our special agents in this manner.

REIMBURSEMENTS TO STATE AND LOCAL GOVERNMENTS

Senator CHILES. The Service currently has approximately $6.4 million available to it for reimbursement to the State and local governments. What is the total for bills already submitted to the Secret Service for this program?

Mr. DAVIS. Senator, we have received, or expect to receive bills that we know about in excess of $8 million. We expect to pay within the next week a bill in excess of $6 million.

In addition, there are certain missions which are being protected in New York with extraordinary protection, largely at the request of the State Department, for which New York will also plan on submitting bills.

This is a category of expenditure that has become increasingly sensitive in the past 6 months because at the same time that we were confronted with, and are still confronted with, problems and concerns and tragedies in some of our embassies, last fall there was a series of bombings at some of the U.N. missions in New York. That situation focused on us, the State Department and others, the importance of us—meaning the U.S. Government—providing the capability to provide adequate security for those missions at a time when we were pressing other governments to expand the protection for our facilities overseas. One of the reasons why we are requesting the supplemental is so that we can pay some moneys for protection of these missions.

INVESTIGATIVE STATISTICS

Senator CHILES. I notice that the analysis of caseload statistics for the last 5 years shows that less than 10 percent of the counterfeiting, check forgery, bond forgery, and other nonprotective cases result in an arrest. Doesn't that imply that the Service is pursuing a large number of low-priority cases?

Mr. KNIGHT. I am not certain of the analysis, Senator. I can tell you that in the past 2 years the Secret Service has made more than 21,000 arrests, with a conviction rate exceeding 95 percent.

Now when one investigates 100,000 or 200,000 cases, certainly not every one of them results in an arrest, and there may be only one charge or arrest covering many cases.

ADDITIONAL QUESTIONS

Senator CHILES. I will give you this information and we will see if we can get some further information on that.

I have a series of other questions that we will ask for the record.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

Additional Committee Questions

FISCAL YEAR 1981 EQUIPMENT INCREASES

Question: The Service has requested $500,000 to replace alarm systems at the White House, the Blair House, and the Vice President's Residence. Please describe the deficiencies in the current alarm systems.

Answer : As a result of a recent cut in funds for the 1981 fiscal year budget, the funds requested have been reduced to $350,000 which will cover the replacement of security annunciator equipment at the White House only.

It should be noted that the actual alarm sensors are not being replaced. The units actually being replaced are the security annunciators which provide the alarm status information of each area protected by the alarm sensors to officers stationed in the Uniformed Division Control Center. In addition, the alarm annunciators monitor the lines (cable) between the alarm sensors and the control center to insure that no one has tampered with them.

The present security annunciators were installed in 1971 and are nearing the end of their operational life (10 years). Money for the replacement of these units has been cut from both the FY 1979 and 1980 budgets thus overextending the period for which the units must operate.

Some factors which necessitate replacing the current security annunciators at this time are:

1. Current units are at the end of their operational life and are requiring increased maintenance and repair. By the time the new units can be installed the current units will have been operating for 12 years, 2 years longer than their expected operating life.

2. The number of service calls related to the White House security alarm system and annunciators has been monitored for the past 2½ years. Conservatively, the number of service calls has doubled during this period which is indicative of the units nearing the end of their operational life.

3. With the advances in electronics technology in the area of signal processing, the new annunciators will be designed to provide increased line security to resist tampering as well as more reliable state-of-the art electronics.

Question: $350,000 is requested to purchase three prototype walkie-talkies with secure voice systems. If these prototypes would prove successful, what would be the total cost of converting to the new walkie-talkie?

Answer : It should be noted that the Service intended including a voice privacy system not a secure voice system in the units. However, the funds for this program were deleted due to President Carter's last budget limiting requirement.

Question: With the current system the Service is required to use code words and frequent changes in the frequencies in order to maintain a secure communications system. Why can't this system be continued?

Answer : In order to insure adequate security for protectees it is essential for communications within the Secret Service to remain undisclosed to the public.

The Secret Service radio system currently in use was adopted prior to the commercial availability of radio frequency scanners. For years it provided what was thought to be a relatively secure means of communications. However, recent advancements in radio equipment now makes it possible for virtually anyone to monitor our radio traffic without sophisticated equipment and at a very minimum expense.

Secret Service codes have always been kept to a minimum in order to insure that vital security related information is not misunderstood. It is a well known fact that the error factor in code translations increases proportionately with code complexity. Therefore, it is always in the best interest of those involved to eliminate the use of codes whenever possible because they cannot be relied upon under emergency conditions. Further, because of the sheer numbers and various positions of the personnel involved in protectee movements, it is an ever increasing possibility that any code system can be compromised without any detection.

DUPLICATE COMPUTER ACQUISITION

Question: We understand from GAO that you recently installed two new identical computers side-by-side in the same room at the Washington Headquarters. We were told that because of the sensitive nature of the information stored on one, the Service felt the need for two computers. Would you explain the need for two computers rather than a single larger computer?

Answer : The Secret Service has kept very sensitive information on individuals in its computer system within the Headquarters complex. This information has bearing on the safety and the protection of the President and his family, the Vice President and his family and other persons designated for protection. The information is used in evaluating threats to these protectees and in developing plans and procedures for implementing this protection and for other protective functions. In order to protect this information in a communications environment, it was necessary to isolate it on a separate computer. The Service has historically confined this information to the Intelligence Division, Office of Protective Research.

This approach also facilitated implementation of the terms of The Privacy Act of 1974. The information is kept segregated from other information of a less sensitive nature by placing it on a separate computer with its own dedicated, permanent communications circuits.

The intelligence function must support the Service on a 24-hour-a-day basis. In order to provide this capability, the computer system at Headquarters must be operational at all times. A single larger computer would be subject to failure that would prevent the operation of the facility in a responsive manner. Recently, the Service experienced a failure of a major component within the new computer system. This failure was so severe that the component was not repairable and the component had to be replaced. The replacement time for this component was thirty days. During this period, a single larger computer would have been completely unavailable. No computer support would then have been possible. The newly installed equipment allowed for the re-configuration of the equipment to bypass the failed component. This ability allowed the system to be recovered within one-half hour of the diagnosis of the failure. A single larger system is inherently susceptible to failures of this kind. To meet the operational needs of the Service, a fully dual system is required.

The systems actually acquired are not identical. Only the main computer components are identical. The tape and disc drives for each system are selected to meet the needs of that system. Special switching equipment has been procured that will allow for peripheral equipment to be moved to either computer as the need dictates. In this way, the Service is able to tailor the size of the computer to the processing requirement at that time. Needed capacity will be moved from the one computer and placed on the other computer as processing requirements dictate.

Question: Why couldn't you just program the necessary information security that you need on the larger computer?

Answer : At the time of the procurement action, computer technology did not provide for the level of security required. Modern computers when programmed for time-sharing, interactive access so essential for the efficient creation and modification of application systems do not provide for this level of security. A survey of the capabilities of the market at that time developed only one vendor and only one computer which had the level of security built in that was needed. This vendor, Honeywell Information Systems, and the system MULTICS, would have had to be procured on a sole-source basis to meet the security needs that dual systems provide. On the basis of the GSA schedule, a system equivalent to the dual system actually acquired would have cost significantly more than the systems actually acquired. The central processors of the Honeywell Information Systems model 66/40 systems with 524,288 words of memory have a schedule cost of $1,905,465.00 each. The corresponding larger system with the requisite security is the model 68/60. It has a schedule price of $3,523,960.00 for the single computer plus an additional cost of $1,393,090.00 for a second processor unit that provides the reliability and backup capability the Service needs. The cost of the peripheral devices (disc, tapes, printers, etc.) is the same for either computer since these units were required to meet the processing workload. Thus the overall cost difference between the two approaches in today's dollars is $1,106,120.00, a potential savings for obtaining the dual computers rather than the single larger system. In addition, since the two computer system was procured under fully competitive conditions as required by the Brooks bill, the actual cost to the government for the two computer system was considerable less than the GSA schedule price. The proposed price for the acquired systems was substantially discounted from the GSA schedule price.

Question: Did you prepare a feasibility study which explored the cost of a single computer modified to provide the security requirements versus the cost of two computers?

Answer : The requirement for the equipment redundancy to provide the required operational availability effectively precluded consideration of the single, large computer approach. The Service decided on the course of meeting operational requirements for reliability by specifying the functional needs to be proposed. Since a single system without dual processor capability cannot, by definition, provide the level of availability required, no feasibility study along those specific lines was prepared.

Question: Can you provide any figures relating to utilization levels of the computers? If you do have figures available, do you intend to make utilization measurements in the future?

Answer : The computer systems are not completely installed at this time. Also, the conversion of the old software systems from the computers being replaced is not yet complete. The major thrust of the effort over the last year has been to accomplish these two tasks. As a result, only the most peripheral utilization data is available.

The Service is in the process of defining the accounting procedures needed to provide program managers with the data processing cost data necessary to effectively manage their use of the data processing resource. Detailed performance reviews will be done as qualified staff are developed in this highly specialized area.

Question: Have you experienced any productivity improvements in terms of mission-related work as a result of the installation of the computers? If so, are you able to state these results in dollar savings?

Answer : Although the Service has not completed the transition, to the new computers the Service has experienced productivity improvements in terms of mission-related work as a result of the installation of the computers. We are not able to state these improvements in terms of dollar savings. Although cost-savings were a large part of the consideration for the replacement of the older computers, the prime need for the computers was and is the providing of timely intelligence information for the protective function of the Secret Service. This function, and the automated environment developed to support it, are called for in the Warren Commission report to automate the Protective Intelligence Data Base. It called for providing a means of comprehensive evaluation and analysis of this data in a timely manner. Under the old manual system, it became physically impossible to review more than 100 to 200 cases in preparation for a trip or visit by a person under Secret Service protection. Under the new automated system, the entire file of 40,000 cases can be searched and examined in a few hours. Additional productivity is expected for the new computers.

Question: Do you have plans to automate more systems in the near future? If so, would you provide a brief summary of your plans as they relate to Automatic Data Processing?

Answer : The Secret Service has developed and adopted an oversight and planning function under the Department of Treasury Directive TD 10-08. This planning and oversight function requires the development of, on an annual basis, an ADP long range plan. All proposed systems or changes to existing systems must be included in this plan. It is reviewed and prioritized by the Steering Committee for ADP within the Service. In addition, all previously developed systems must be audited at least every three years to determine if the system is still needed or if it meets the current needs of the Service. No new systems may be developed nor any significant changes made to an existing system without the review and approval of the Steering Committee. All approvals are required to be stated in terms of clear priority within the long range plan.

The Service has approved the development of a pilot system to automate the index to cases in support of the Field Offices. This system will replace the existing manual system now used. At the end of the pilot system development, the Steering Committee will be given the results of an audit of this system for use in considering whether to automate all such Field Office indices.

The Steering Committee is currently considering a broad range of projects for automation compiled over the last year. Projects such as automation and weekly distribution of a report of counterfeit activity which now takes three weeks to produce. The revision of the property and financial systems to be more effective and responsive to the planning needs of the Service are included in the items under consideration. The systems being considered touch each operating unit of the Secret Service and are all addressed to the need to provide management with more timely information needed for rapid and correct decisions.

LESS THAN 10% OF COUNTERFEITING CASES RESULT IN ARRESTS

Question: Analysis of caseload statistics for the last five years (FY 1981 Congressional Submission, Vol. II, SS 2-5) shows that less than 10% of the counterfeiting, check forgery, bond forgery, and other non-protective cases result in an arrest. Doesn't this imply that the Secret Service is pursuing a large number of low priority cases?

Answer : The analysis of caseload statistics for the last five years as they appear in our FY 1981 congressional submission could at a quick glance lead to a conclusion that the Secret Service is pursuing a large number of low priority cases to the detriment of major cases. Nothing could be further from the truth or the reality.

It has been noted that less than 10% of counterfeit cases result in arrests. At first glance, this statistic would seem to confirm that the Secret Service pursues low priority cases that often lead to a dead end. While many of our investigations in fact lead to a dead end, they are anything but low priority.

Approximately 60% of our counterfeit caseload involves the investigation of actual counterfeits passed on the general public. As these counterfeit notes are brought to the attention of our field offices, agents respond to individual victims in an effort to glean investigative leads. Each note passed is treated as an avenue which could lead to the manufacturer, despite the reality that many cases simply do not have the potential for arrests due to external factors beyond our control.

We conduct these investigations knowing that they directly impact on another statistic which we feel is the acid test. For many years the Secret Service has seized approximately 90% of all counterfeit notes manufactured prior to their circulation. However, the best measure is the ratio of the dollar value of counterfeit notes seized to the dollar value of counterfeit notes seized plus counterfeit notes passed. To a large extent we are able to maintain this high ratio because we attach significance to each counterfeit note passed regardless of the potential for arrest. If we were to selectively handle investigations based on the potential for arrests, the seizure rate would suffer. We emphasize suppression over arrests because our primary mission in the field of counterfeit investigations is to protect the integrity of U. S. Currency.

In the area of check and bond forgery investigations, a review of caseload statistics over the past 5 years indicates that in an average year the number of arrests made is slightly below 10% of the total number of cases investigated. One factor that impacts substantially on these percentages is the amount of multiple check and bond forgery activity. A multiple case is defined as any case wherein an individual or group of individuals is responsible for the forgery and negotiation of more than one check or bond.

In the average year, multiple activity accounts for somewhere between 35% to 38% of all check investigations. In some years multiple activity in the bond forgery area has accounted for as high as 46% of all cases investigated. The following table provides a breakdown by year of the number of cases in the check and bond forgery area which represent multiple activity.

Five Years

		Total Check & Bond Cases	Total Associations	Total Check & Bond Arrest	% Cleared
1979	Check	59,495	13,985 (24%)	6,457	64
	Bond	9,624	3,520 (36%)	133	69
1978	Check	112,000	40,271 (35%)	9,409	60
	Bond	10,399	3,424 (33%)	164	66
1977	Check	121,022	42,422 (35%)	8,779	54
	Bond	12,189	5,617 (46%)	152	64
1976	Check	108,724	41,806 (38%)	5,171	57
	Bond	14,356	6,564 (46%)	144	65
1975	Check	78,148	28,079 (36%)	6,602	53
	Bond	12,645	4,171 (33%)	199	73

It should be pointed out that a multiple check forgery group consisting of three persons could be responsible for the forgery and negotiation of as many as 300 U.S. Treasury checks. When this group operation is broken up the result will be three arrests for 300 check investigations. Hence, in this case the number of arrests will represent only 1% of the cases investigated.

Another factor which impacts negatively on arrest statistics has to do with declination policies being enforced by a number of U. S. Attorney's Offices. At the direction of the Department of Justice, many U. S. Attorney's Offices have set up declination policies wherein many check investigations that would have previously resulted in arrests are not now being prosecuted. A typical declination policy involves the setting of a dollar amount such as $500 or $1,000 below which no prosecution will be authorized. Some U. S. Attorney's Offices insist that there be a minimum number of checks involved before prosecution will be authorized.

Question: What are the investigative standards or guidelines used in determining whether or not and to what extent a case should be pursued?

Answer : In counterfeit investigations, our emphasis on suppression leads to a concentration of resources on major cases involving manufacturing and high level distribution rings. However, this emphasis does not exclude counterfeit note passing activity. The counterfeit note passer is seen as a link in the chain that leads back to the manufacturer. The passer of a counterfeit note who knows that it is counterfeit can identify and deal with his source. The pursuit of investigative leads in counterfeit note passing cases is a vital investigative tool in the suppression of currency counterfeiting.

The fact that we investigate counterfeit note passing activity, is not to say that we spin our wheels on non-productive work. Thousands of counterfeit note passes are not investigated because there are no investigative leads. Only those counterfeit passes that have leads or which appear to have leads are pursued. As soon as it is found that the investigation has reached a dead end, the case is closed. A short form reporting system has been developed which saves both agent and clerical time.

The main thrust of our investigation in the check and bond forgery area is to identify and pursue the multiple operation. We open investigations on all check and bond forgery cases referred to us. We pursue investigative leads until there is a dead end. In many thousands of the cases which we open there are either very few or no investigative leads and these cases are closed out quickly on a short form reporting procedure which saves agent and clerical time. It is pointed out that many multiple operations are detected by the pursuit of investigative leads in cases which do not appear on the face to indicate multiple activity.

Question: What types of cases are least likely to be pursued when additional resources are needed for presidential campaigns?

Answer : The types of cases least likely to be pursued when additional resources are needed for Presidential Campaigns are check forgery investigations.

Question: The Secret Service is responsible for investigating forgery and fraudulent negotiations of government bonds and checks. The number of such cases received by the Secret Service continues to decline. Does the increasing use by the Federal Government of electronic fund transfer explain this decreasing trend of forgery of government checks and bonds?

Answer : Despite the electronic fund transfer and direct deposit programs, more checks have been paid by the Treasury Department in the first 5 months of the present fiscal year than were paid in the first 5 months of FY 1979. There is a 4.5% increase. In addition, the Secret Service has found the impact of these programs minimal as concerning check forgery activity. The great volume of our forgery check cases arise in the inner city areas of major cities. The number of check recipients in these areas participating in direct deposit or electronic fund transfer programs is very small. Electronic Fund Transfer has no impact on the theft of forgery of bonds.

REPROGRAMMING FOR TRAVEL FUNDS

Question: How much has been obligated to date for travel?

Answer : Through March 31, 1980, the Secret Service had travel obligations of $8,007,000.

Question: Do you believe that the obligation rate for travel during the second half of this fiscal year will exceed the obligation rate during the first half? If so, why?

Answer : Based on projections and known occurences, the travel obligations for the second half of FY 1980 will exceed those for the first half of FY 1980. Much of the increase in the second half is attributable to the Presidential Campaign. At this time, we anticipate there will be three presidential nominees eligible for Secret Service protection. Also, the three vice-presidential nominees and the spouses of presidential and vice-presidential nominees are eligible for protection. This means that up to twelve individuals will be in travel status simultaneously.

Significant travel obligations will be incurred in relation to the protective operations at the Democratic and Republican national conventions and an anticipated third party convention. Because these are public events of great importance involving massive national exposure, a secure environment is necessary for the protectees. To achieve this, it will be necessary to bring in large numbers of special agents from various field offices throughout the country. In addition, previous campaign experience has shown that candidate travel picks up significantly immediately prior to the national conventions.

The United Nations General Assembly begins its 35th session in September. This has always brought about a significant increase in foreign dignitary travel. Dignitaries traveling to the United States for this event, usually continue their travel after stopping in New York. Significant travel obligations can be expected as a result of this.

Payments to State and Local Governments

Question: How much has been paid to New York City in Fiscal Year 1980 to date?

Answer : The total amount paid to New York City from October 1, 1979 through April 30, 1980 is $5,976,022.42.

Question: How much funding remains available to pay additional amounts to New York City for this year?

Answer : Currently, the Secret Service has a balance remaining of $344,788.49 for payment to New York City this fiscal year. However, there is also a supplemental pending in the House and Senate. If approved the Secret Service will have an additional amount of $2,750,000 available for payment to New York City.

Question: How much in unpaid bills does the Treasury Department currently have from New York City?

Answer : At the present time, there is one bill on hand for payment to New York City, totalling $92,347.47. The bill has been audited and approved for payment, but has not been disbursed. Furthermore, we understand that we will soon receive a bill for costs arising from the Fall, 1979, U.N. General Assembly, and for protection at certain missions.

Question: Of the amounts already paid this year and of currently unpaid bills, how much is for retroactive payments prior to this fiscal year?

Answer : Of the total amount of $5,976,022.42 paid this fiscal year, $215,174.55 represents payment against a bill received from New York City during fiscal year 1979 for protective services rendered during the period September 3, 1978 through December 21, 1978, which represents approximately 25% for fiscal year 1978 and 75% for fiscal year 1979.

Question: What is the total dollar value of New York payments to date and what is the total value of bills submitted by New York City since passage of P.L. 94-196?

Answer : The total dollar value of New York payments from inception of P.L. 94-196 to date are as follows:

	Amount Billed	Amount Paid
FY 1980	$6,844,530.16	$5,976,022.42
FY 1979	1,700,793.24	145,083.62
FY 1978	80,569.62	65,366.31
FY 1977	1,220,302.71	1,218,739.16
Total	$9,846,195.73	$7,405,211.51

PREMIUM PAY AND SCHEDULED OVERTIME

Question: Do agents and others earn both premium pay and time and one-half overtime when permanently assigned to a protective detail?

Answer : Yes.

Question: The legislation that provided for premium pay compensation was approved by Congress to cover the hours worked by an investigator who, on his own judgement, had to work beyond his normal duty hours in order to complete his assignment. A good example might be when an agent working undercover sets up a meeting to purchase some bogus money. He would be required to continue to work until the buy was made. However, we have a problem understanding the rationale for people receiving premium pay while on permanent assignment to a protective detail where shifts are scheduled in advance. Please explain the rationale for the payment of premium pay while on protective duty?

Answer : Special Agents assigned to permanent protective details are eligible for overtime under the provisions of two separate laws as follows:

Title 5 U. S. Code, Section 5545 C.2 - This law provides for compensation for overtime which is administratively uncontrollable (AUO) and is not scheduled in advance. A simple example of situations which require compensation under this statute---

> A protectee announces that he will be attending a function at the last minute. A working shift is required to either come in early or work late in order to provide the manpower necessary to meet the security requirements.

Title 5 U. S. Code, Section 5542 - This law provides for compensation for overtime which is scheduled in advance (SOT). Public Law 91-231 provides for compensation in both of the above cited categories, AUO and SOT if certain provisions are met in the scheduling process. These provisions are that scheduled hours must be (1) recurring, (2) scheduled in advance, (3) symmetry of hours (same number of hours). The Secret Service has by necessity interpreted these requirements and the Service's interpretation appears to have the approval of the Comptroller General as evidenced by the Comptroller General's decisions B-144390 and B-164689. A simple example of a situation which requires compensation under this statute:

> On Monday a protectee announces a two day visit to a distant location on the following Saturday and Sunday. In order to save travel expenses, a decision is made to send only two (2) working shifts instead of three (3). The two working shifts are subsequently scheduled in advance to work recurring 12 hour tours of duty.

UNIFORMED DIVISION

Question: How much was spent on overtime during the last fiscal year and the current year to date for the Uniformed Division of the U. S. Secret Service?

Answer : Overtime costs for the Uniformed Division in FY 1979 totalled $1,173,679. FY 1980 overtime costs through April 5, 1980 were $877,267.

Question: Do you have in your budget base and do you anticipate spending similar amounts in FY 1981?

Answer : The Secret Service does not budget scheduled overtime by organizational unit. Therefore, it would be difficult to determine how much is allocated to the Uniformed Division. Extraordinary international crises, along with reduced manpower, have caused increases in the amount of necessary overtime thus far in FY 1980.

Without a change in the international situation, and at the continued depressed levels of manpower, it can be anticipated that the Uniformed Division will be required to perform, at a minimum, similar amounts of overtime in FY 1981.

Question: Don't you feel it would be more cost effective to use this money for additional positions rather than paying the overtime?

Answer : Yes, it would be more cost effective to use money for additional positions rather than pay increasing amounts of overtime. Unfortunately, hiring ceilings and budgetary constraints have combined to restrict the Service from acquiring additional positions for the Uniformed Division.

The hiring of additional personnel, if permitted, would reduce overtime but not eliminate it. The Uniformed Division performs much of its protective mission at the request of the State Department. The volatile world situation could cause protection at a foreign mission to increase at a moment's notice, as was the case at the Embassy of Iran. Situations of this type have made the increasing use of overtime unavoidable.

Question: Did you request any additional positions in FY 1981?

Answer : The FY 1981 Spring Preview prepared by the Service requested 201 additional positions for the Uniformed Division. The Secretary's allowance was 13 positions, none of which were allowed by OMB.

VOICE PRIVACY

Question: Mr. Knight, a few years back you testified that you needed $3,500,000 to convert your entire communications system to one that could not be monitored by the general public. We, the Congress, provided you with these funds. Has the entire system been converted?

Answer : The entire system has not been converted. The technique of reducing the necessary components to the extremely small size required has taken the contractor longer than anticipated. Our original goal was conversion of the system in time for Campaign 80. The contractor now advises that completion of the present stage of the program will be December 1980.

Question: How much have you obligated to date for this system and what is your current estimated cost to convert your entire system?

Answer : To date, approximately $4,423,000 has been obligated for the system. These funds will allow for conversion of 41% of the handie-talkies, 22% of the mobile radios, 47% of the radio base stations and 34% of the devices necessary to program the radios.

Our current estimated cost to convert the entire system is an additional $8,000,000, should we decide to do so. This includes $500,000 for spare parts and approximately 500 units added to the inventory since 1976.

Question: Why do your current expenditures exceed the original amount requested?

Answer : Current obligations exceed the original amount requested because of the following reasons:

1. Additional features were added to the radios after the original estimate.
2. This project was one of "pushing technology". The techniques of miniaturization needed in the project did not proceed as quickly as estimated.
3. The cost of the devices necessary to program the radios was not in the original estimate. This item was not a modification as is the rest of the system, but has to be manufactured. Costs of the unit could not be accurately projected at the time of the original estimate.
4. We considered it more efficient and less expensive in the long run to ask the contractor to perform the modifications rather than attempting to do it "in house".

Question: Isn't this a cost overrun?

Answer : Yes, it is a cost overrun but not in the commonly held sense. The contract was a closed end one. Additions to the system and other factors enumerated above also impacted the costs. Because the contractor is late in delivering the units for Campaign 80 as originally agreed, the Service expects to be compensated. The amount of this compensation is not known at this time.

The Service has borne the initial engineering costs for this system. However, the benefits of the system will be government-wide. Other Federal law enforcement agencies are planning to obtain the system and several other Federal agencies are interested in it.

Question: How was Congress informed that this system was far exceeding the original estimate?

Answer : The Congress was not informed the system was exceeding the original estimate. The Service did not have the relevant information until it became clear the contractor would be unable to hold to the original estimates.

CAMPAIGN PROTECTION

Question: Compared to previous presidential elections, is the Secret Service using more agents from other Treasury bureaus in the current campaign? Why is the Service using more agents from other agencies instead of its own manpower?

Answer : Based on the most recent other Treasury Agent manhour report, the Secret Service is utilizing fewer agents from other Treasury bureaus for the 1980 campaign as compared to the 1976 campaign.

Question: Please furnish the Committee with a list of expenditures by object class showing obligations to date compared to the same date as the last election. Show seperately the manpower provided by other agencies together with the amounts to be reimbursed to those agencies.

Answer : Total estimated obligations by object class for the 1976 and 1980 Presidential campaign through March 1976 and March 1980 are as follows:

	1976 Campaign	1980 Campaign
	(Dollars in	Thousands)
Personnel Compensation (Overtime)	$1,460	$2,174
Travel & Transportation of Persons	4,864	3,467
Transportation of Things	1	21
Rent, Communications and Utilities	36	87
Printing and Reproduction	--	--
Other Services	25	984
Supplies and Materials	82	94
Equipment	989	1,183
	$7,457	$8,010

Total manhours and reimbursable costs associated with Other Federal Agencies in support of our Candidate and Nominee Program through March 1976 and March 1980 respectively are as follows:

	Manhours[1]	Reimbursable Amount (dollars in thousands)
1976 Campaign	142,296	$353
1980 Campaign	71,085	$833[2]

[1] Manhours are maintained only for the services provided by other Treasury agencies in support of our Candidate/Nominee program.

[2] The passage of Public Law 94-524, the Presidential Protection Assistance Act, which was approved on October 17, 1976, has required the Secret Service to reimburse other Federal agencies, with certain exceptions, for assistance rendered in the performance of its protective duties. Consequently, the Secret Service is now required to reimburse, in addition to other Treasury agencies, the Department of Defense, and others for their support of our protective responsibilities.

INVESTIGATIVE CASELOAD

Question: In reviewing the statistics in your justification submission, the investigation case load is down. Has a corresponding reduction in manpower been incorporated in the amount approved by OMB to be included in the current appropriation request?

Answer : A corresponding reduction in manpower has not been incorporated in the amount approved by OMB to be included in the current appropriation request in light of a declining investigative case load. The main reason for this is that there is a backlog of at least 128,000 forgery check cases in the Treasury Department's Bureau of Government Financial Operations, Check Claims Division, which should have been referred to the Secret Service. Efforts are being made to do away with this backlog situation and it is anticipated that by late 1980 or early 1981 well over 100,000 of these cases will be referred to the Secret Service for investigation.

Another reason why there has not been a reduction in manpower involves the fact that the Service needs a minimum number of agents assigned to Field Offices in order to properly carry out its protective functions. Agents assigned to Field Offices provide protective support to permanent and temporary protectees when they visit a particular field location. Agents assigned to our Field Offices are also selected for temporary travelling protective details for foreign dignitaries and candidates, who receive Secret Service protection. On almost a daily basis, Field Office agents in one location are moved to other cities to provide support for visiting permanent and temporary protectees of the Service. Field Office agents are also required to provide intelligence information and liaison with local police departments in connection with these visits of protectees to various geographic locations.

Question:	Has the increased use of direct deposits affected check forgery investigations?
Answer :	Despite the electronic fund transfer and direct deposit programs, more checks have been paid by the Treasury Department in the first 5 months of the present fiscal year than were paid in the first 5 months of FY 1979. There is a 4.5% increase. In addition, the Secret Service has found the impact of these programs minimal as concerning check forgery activity. The great volume of our forgery check cases arise in the inner city areas of major cities. The number of check recipients in these areas participating in direct deposit or electronic fund transfer programs is very small.
Question:	Why hasn't the Treasury Department pursued the direct deposit program more vigorously thereby reducing the number of stolen and forged checks which should result in a substantial savings to the government not only in the Secret Service, but also in postal services investigations as well as check claims?
Answer :	The Treasury Department hopes for 30% voluntary participation in the government-wide direct deposit program by fiscal year 1982. Specific reference is made to a publication put out in 1979 by Treasury's Fiscal Service -- Operations, Planning and Research Staff, entitled "Direct Deposit of Social Security Payments -- A Beneficiary Survey." That survey draws 22 conclusions about the direct deposit program as it related to education, race, annual income, etc. The major reason for not enrolling in the direct deposit program is because participants "like to see and handle their own checks." There appears to be an attitude problem with the direct deposit program which hindered greater participation even though Treasury has vigorously encouraged using direct deposit by using check inserts and media messages.

TRAVEL COSTS

Question:	For the current Fiscal Year, Congress has placed a limitation on the amount agencies may spend on travel. How has this affected your operations?
Answer :	Due to the essential nature of our travel, the Treasury Department has not required the Service to absorb any of the FY 1980 travel reduction mandated by Congress. Despite the absence of a reduction, the Service has been incurring travel costs in excess of funded levels. The supplemental request currently before the Congress is essential for the Service to continue its current rate of operational travel in support of its protective mission throughout the remainder of FY 1980.

Question: How much money has been obligated for the current Fiscal Year to date for administratively controllable travel.

Please submit for the record these obligations in the following categories:

a) Conferences including participation in EEO meetings and other specialized gatherings by activity
b) Speaking engagements
c) Other public affairs activities
d) Changes in official duty stations

Answer : As of March 31, 1980, the Secret Service has obligated funds in the amount of $349,964. The Service does not consider changes in official duty stations to be controllable. The career development of our special agents require that they have practical experience in both areas of the Secret Service's law enforcement mission; criminal investigations and protective security.

a) Conferences and Competitions	$103,466
b) Speaking engagements	---[1/]
c) Other public affairs activities	5,748
d) Changes in official duty stations	240,750

[1/] Obligations for speaking engagements are included with other public activities.

CONSOLIDATED BUILDING SITE

Question: In the past, you have indicated the need for a consolidated location. What progress has been made toward achieving this worthwhile goal?

Answer : For the past three (3) years, we have been actively working towards the acquisition of a single site in which to consolidate Secret Service offices in the Washington Metropolitan Area. During this period, we have been working both with the Department of the Treasury and the General Services Administration (GSA). A comprehensive study indicating the advantages of consolidation was completed and sent to Treasury for their review and approval. Treasury recently released the study to GSA. That study substantiated the need for consolidation and documented that over $500,000 in administrative costs per year could be saved by consolidation. In addition, the study showed that we could vastly improve our security by being in one location.

It should be noted that, to date, we have made no tangible progress towards consolidation. In fact, the number of Secret Service office locations has increased from 5 to 6. To make matters worse, there is now a potential for our locations to be increased to 9.

As we have indicated in previous testimony, the building at 1800 G Street, which now houses a portion of our Headquarters activities, is the most logical site from every standpoint for the consolidation. We propose to acquire space at this site on an incremental basis and have submitted the necessary documents to GSA for that purpose.

PROTECTIVE RESEARCH

Question: What is the potential for terrorist activity in this country during the coming presidential campaign?

Answer : The use of terrorism to accentuate political disaffection is still considered by many to be an effective and oftentimes successful weapon. As such, the potential for terrorist activity in the United States, whether directed against persons/facilities protected by the Secret Service or other highly visible/politically expedient targets, exists at the present time and will continue to exist given today's world.

In general, today's terrorists are capable of more sophistication in both their operational techniques and security methods to elude detection, as well as the resources they have available. The Secret Service must always be prepared to combat any form of terrorist action, from the impersonal bombing to the armed terrorist attack, to ensure the maximum possible safety of its protectees. This country is not immune to such attacks and the better the intelligence gathering capabilities, the better the ability of law enforcement to forestall actions by international terrorists or violent groups in the United States. In fact, the United States may be regarded as more susceptible since during recent years international terrorists have shown a preference for targets in industrialized democracies.

Although there may be few terrorist groups which are indigenous to this country, the ones that do exist present a continuing serious threat and their capabilities must be taken into consideration when planning any security response. Each of these groups has a grievance, generally political in nature, and dependent upon the given situation and time, may find it expedient to target an individual or facility here. This is especially applicable during this period when there are significant issues at stake and many highly visible targets travelling throughout this country whose victimization would provide much desired publicity on the part of any given terrorist group.

This is also true regarding the numerous foreign terrorist groups which would find in this country any number of suitable targets to match their grievances. The potential is high for the variety of foreign causes and issues to be transported here in the form of terrorism against Service protected persons and facilities which include not only the President and other U.S. protectees, but visiting foreign heads of state/government and all diplomatic facilities in Washington, D.C.

Although statistics on actual terrorist acts may rise and fall given the area of the world and conditions at the time the trend is to keep the use of terrorism as an effective weapon to achieve real or imagined goals.

Question: Can law enforcement agencies freely exchange information on terrorist groups?

Answer : The restraints imposed by the Freedom of Information and Privacy Acts as well as the restrictive interpretation of guidelines under which the various agencies are required to operate may delay or preclude an exchange. This is not due to a lack of willingness by any particular agency to cooperate with other law enforcement agencies, but rather, to the fact they may not have the information any more, there may be prohibitive from freely providing the information because of imposed restrictions, or they may no longer be tracking terrorist groups and collecting information as they once did.

Question: Have the Attorney General's guidelines for intelligence gatherings by the FBI and CIA affected the flow of intelligence information to the Secret Service?

Answer : It is understood that the Secret Service does not have the primary jurisdiction for investigating and/or collecting intelligence information. As such, it relies heavily on other local, state and federal agencies, especially the FBI and CIA, to supply the necessary intelligence to supplement activities required to perform its protective mission. This follows the findings of the Warren Commission which suggested that the Secret Service increase its efforts to identify persons and groups who could compromise the safety of the President and recommended that other agencies furnish intelligence data to the Secret Service to enhance Presidential security.

In the years following the Warren Commission the Service developed working relationships with these agencies and provided them with guidelines delineating its responsibilities as well as the kinds of information needed for an analysis of the security requirements in any given situation. Based on the information provided the Service could then take any appropriate steps to nullify and negate any violent action which might be directed at the persons and/or facilities that it is directed to protect.

The ability of the Service to adequately evaluate its operational needs in any given situation has been hampered by the reduction in the quantity and often times quality of the information received from local, state and federal agencies. This is not due to a lack of willingness, as mentioned previously, but rather the necessary information may not be available. Local and state agencies, in particular, have exhibited an increasing concern over the potential compromise of confidential sources of information supplied to federal agencies. The perceived uncertainties associated with the Freedom of Information and Privacy Acts has tended to inhibit the free exchange of information.

Several other factors have contributed to the apparent inability of these agencies to aggressively investigate/collect information that is considered essential to the Secret Service. These also include the restraints imposed by the Freedom of Information and Privacy Acts as well as the restrictive interpretation of guidelines under which the various agencies are required to operate. In this instance, the most influential set of guidelines have been those promulgated by the Attorney General.

The Secret Service is a preventative agency. The information received from other agencies is evaluated as to any impact on the Service's protective mission. With the heavy reliance on the intelligence information received in the past, the Service felt it could adequately perform its function with regard to preparing for any situation. With the reduction in the information which it can now expect, both in specificity and in completeness, the Service cannot with any certainty judge what manpower is necessary. There is insufficient data on which to make a judgment, thus it is necessary to increase the manpower deployment to offset the perceived intelligence gaps.

In saying this, however, the Service recognizes that its perspective is solely that of an agency with the specific operational responsibilities. Guidelines that have been developed in this area must balance not only agency needs, but the right of individual citizens.

Question: What impact has the Freedom of Information Act and the Privacy Act had on your operations?

Answer : The Secret Service is primarily a receiver of intelligence information and as such it relies heavily on information provided by both law enforcement and non-law enforcement organizations to perform its protective responsibilities. Based on contacts with these various organizations, consisting of federal, state and local agencies, the Service can only conclude that the Freedom of Information Act and the Privacy Act have served to inhibit the collection as well as exchange of intelligence information - information which can impact significantly on the security effort of this Service.

In congressional testimony, law enforcement officials at all levels of government have stated that these laws as enacted have been instrumental in creating a restrictive climate which affects their ability to obtain information from the public and institutions, to recruit and maintain informants, and to exchange information with other law enforcement agencies. From the Service's view both the quality as well as the quantity has suffered.

The goal of the Secret Service's protective efforts is to prevent something from happening, not to solve it after the fact. To this end, accurate and comprehensive intelligence information is indispensable to the successful completion of this mission. To compensate for this lack of information this Service has primarily responded by increasing the number of Special Agents who accompany protectees to provide close-in protection. This is by no means an acceptable substitute for adequate intelligence analysis.

PROTECTION OF FOREIGN MISSIONS

Question: What have been the total costs to the Secret Service since November to provide protection to the Iranian Embassy, Missions and Consulates?

Answer : Through March 29, the costs to the Secret Service as a result of the Iranian Crisis were $464,314. This figure is broken out as follows:

1)	Foreign Missions Branch, Washington, D.C.	$329,822
2)	New York City Detail	104,502
3)	Manpower Replacement for Uniformed Division Members Assigned to New York City Detail	29,991
	Total	$464,315

Question: What are your expenses in New York to protect U.N. Missions and Delegations?

Answer : The only expenses incurred by the Service for protection of U.N. Missions and Delegations in New York during FY 1980 are those related to the protection of the Iranian Mission.

Question: Could, or should, the U.N. pick up the expenses of furnished protection?

Answer : Under international law, the United States is obligated to protect both permanent missions in New York and the United Nations headquarters district.

Article 22(1) of the Vienna Convention on Diplomatic Relations, to which we became a party in 1972, provides that the premises of a diplomatic mission "shall be inviolable." Article 22(2) provides:

> The receiving state is under a special duty to take all appropriate steps to protect the premises of the mission against any intrusion or damage and to prevent any distrubance of the peace of the mission or impairment of its dignity.

The 1963 Vienna Convention contains a similar provision.

General Assembly Resolution 2819 (XXVI) refers to the "international obligations" of the United States, as the host country, to take "all requisite measures to insure the protection and security of the United Nations Headquarters of the missions accredited to it and of their personnel...".

The United States voted for Resolution 2819 (it was adopted unanimously) without objection to its characterization of our international obligations as host country. The legislative history of P.L. 92-539, enacted in 1972 in response to Resolution 2819, contained a similar reference to the "international obligations" of the United States, as a host country.

Article 16 of the Headquarters Agreement between the United States and the United Nations imposes on the United States the specific obligation to "exercise due diligence to ensure that the tranquility of the headquarters district is not disturbed" by entry of persons into the district or by disturbances in the immediate vicinity of the district. This obligation runs to the "appropriate American authorities", defined in article 1, section 1(b) as "such federal, state or local authorities in the United States."

Although there is no specific mention of mission premises in the Headquarters Agreement, the diplomatic status of these premises arises from the diplomatic status of a resident representative and his staff.

SUBCOMMITTEE RECESS

Senator CHILES. The subcommittee will stand in recess until 2 p.m. this afternoon.

[Whereupon, at 12:50 p.m., Thursday, April 17, the subcommittee was recessed, to reconvene at 2 p.m. this same day.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1981

TUESDAY, APRIL 22, 1980

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, D.C.

The subcommittee met at 10:03 a.m., in room 1318, Everett McKinley Dirksen Senate Office Building, Hon. Lawton Chiles (chairman) presiding.

Present: Senators Chiles, Schmitt, and Laxalt.

Also present: Senator Nunn.

Senator CHILES. This morning the committee will receive testimony from the Internal Revenue Service regarding its fiscal year 1981 budget request, the 1981 budget revisions, and the fiscal year 1980 supplemental request.

IRS EFFORTS TO COMBAT NARCOTIC TRAFFICKERS

While we will cover these budget matters with IRS this morning, our special focus will be on the IRS efforts to combat narcotics traffickers and other organized crime figures.

Last December, I participated with Senator Nunn in 5 days of hearings which focused on the increasing ineffectiveness of IRS' efforts to apprehend and prosecute drug traffickers.

Financial investigations, particularly those that can be assisted by the IRS expertise, are one of the most effective ways to penetrate the operational level of drug smuggling rings and organized crime families. In fact, it was the ability of the IRS to conduct such investigations that sent such notorious mobsters as Al Capone and Frank Costello to jail on income tax evasion charges. Today when organized crime and narcotics trafficking are becoming bigger and more sophisticated than ever before, the one law enforcement agency that criminals fear most—the IRS—has almost entirely withdrawn from the battle.

Part of the problem relates to the information disclosure provisions of the Tax Reform Act of 1976, but that is only part of the problem. The rest of it seems to lie with the attitude of the top officials of the Internal Revenue Service, the policies and procedures they have adopted, and the amount of resources that have been devoted to special criminal activities.

Since 1973 the number of special IRS agents assigned to narcotics has been going down to where now only approximately 6 percent of the IRS criminal enforcement division resources are targeted on narcotics.

In August 1979, IRS released its report on the subterranean economy. It was estimated that during tax year 1976 at least $35 billion in income from illegal sources was not reported for tax purposes, including about $24 billion from drug trafficking. In other words, almost 70 percent of the unreported income from illegal sources is drug related. This fact demonstrates to me that the resources IRS has targeted on drug traffickers is totally inconsistent with the size of the drug problem in the United States today.

Today the committee will receive testimony from the General Accounting Office with regard to the administrative actions that IRS could take to facilitate the disclosure of information to law enforcement agencies.

Following that, the committee will hear from the Deputy Attorney General of the Tax Division at the Department of Justice. The Department of Justice will also provide the committee with recommendations as to changes that both IRS and the Department of Justice could make to streamline the IRS disclosure of information process.

The committee will also hear from Mr. Kurtz, the Commissioner of the Internal Revenue Service, on this matter.

Following our discussion of ways in which we can better focus IRS resources on the problem of apprehending the leading drug trafficking figures, the committee will receive general testimony from Mr. Kurtz with regard to his budget proposals. At this time, the committee will begin receiving testimony from Mr. Jones from the General Accounting Office.

Mr. Jones, we are delighted to have you and your associates with us today. If you will introduce your associates, we will be delighted to have your statement.

OPENING STATEMENT OF SENATOR SCHMITT

Senator SCHMITT. Mr. Chairman, just before Mr. Jones begins, I would like to commend you for your emphasis on this general drug trafficking problem. We have seen in the testimony last week with the Customs Service that that agency is having a terribly difficult time getting its act together in coordinating internally as well as with other agencies. It does appear that the Federal Government's total effort with respect to interdicting and prosecuting those involved in drug trafficking is a shambles and that the individual agencies are not doing what it is within their charter to do often because of poor organizational structure within the agencies. There seems to be a definite lack of coordination between agencies that should coordinate and cooperate.

I hope that we are on the verge of seeing this situation improved because the young people of this country are suffering terribly from this almost free flow of hard and soft drugs into the United States.

So, again, I commend you for your efforts and hope I will be able to contribute to them.

Senator CHILES. Thank you, sir.

We certainly look forward to working with you in this regard.

Mr. Jones?

GENERAL ACCOUNTING OFFICE

STATEMENT OF ARNOLD JONES, SENIOR ASSOCIATE DIRECTOR, GENERAL GOVERNMENT DIVISION, GENERAL ACCOUNTING OFFICE

ACCOMPANIED BY:

DAN HARRIS, GROUP DIRECTOR, INTERNAL REVENUE AUDIT SITE
JOHN GUNNER, TEAM LEADER

INTRODUCTION OF ASSOCIATES

Mr. JONES. Mr. Chairman and Senator Schmitt, I would like to introduce to my right Mr. Dan Harris, who is a group director at our Internal Revenue Service audit site, and to my left, Mr. John Gunner, who is the team leader responsible for development of the work that led to this testimony.

PREPARED STATEMENT

Mr. Chairman, I have a full statement which I would like to insert into the record. With your permission, I would like to read from an abbreviated copy, which has been provided to you and the Senators.

Senator CHILES. Your statement in full, without objection, will be entered into the record.

We appreciate your briefing it for us.

[The statement follows:]

STATEMENT OF ARNOLD P. JONES

Our testimony today deals with several specific actions needed to strengthen the ability of various Federal agencies, particularly the Drug Enforcement Administration (DEA) and the Internal Revenue Service (IRS), to deal with the narcotics problem.

Incarcerating major traffickers for long periods and causing forfeiture of their financial resources are key elements to successfully reducing the narcotics problem. This requires close interaction and coordination among Federal law enforcement agencies, including DEA and IRS.

For various reasons, however, neither DEA nor IRS have performed many finance-oriented narcotics investigations.

Knowledge of money flows, along with other information, is essential to identifying and immobilizing narcotics traffickers. Although DEA has the legal authority, under various U.S. code sections, to seek forfeiture of traffickers' illegally derived assets, it does not have the extensive financial expertise needed to perform such investigations. IRS, on the other hand, has the financial expertise and, thus, can play an important role. However, legal obstacles, little overall direction, and changing priorities have hindered these and other agencies from fully using and coordinating their unique skills, jurisdictions, and resources. As a result, the Federal Government lacks a well integrated, balanced, and coordinated approach to the problem and has had only limited success in immobilizing financial resources of high-level traffickers.

To improve Federal efforts to combat narcotics trafficking, the Congress needs to amend the disclosure and summons provisions of the 1976 Tax Reform Act. However, the Tax Reform Act is only one of many impediments affecting Federal efforts. Under existing law, IRS, DEA, and the Justice Department can take certain administrative actions to improve their cooperation and coordination on narcotics matters. Chief among these actions is the need for DEA to make greater use of asset forfeiture authority by focusing more on the financial transactions connected with the narcotics business.

To begin with, however, I would like to discuss the need for legislative revisions to the 1976 Tax Reform Act.

CONGRESS NEEDS TO AMEND THE DISCLOSURE AND SUMMONS PROVISIONS OF THE 1976 TAX REFORM ACT

In our March 12, 1979, report (GGD-78-110) on the effects of the disclosure and summons provisions of the 1976 act, we pointed out that the disclosure provisions had afforded taxpayers increased privacy over information they provide IRS by placing substantial restrictions on access to such information. At the same time, however, these provisions have had some adverse impact on coordination between IRS and other law enforcement agencies.

In December 1979, the Senate Permanent Subcommittee on Investigations held hearings on the narcotics trafficking problem. It concluded that the disclosure provisions had seriously impeded Federal efforts to deal with the problem and needed to be amended.

In our testimony before the Permanent Subcommittee, we supported the need for a revision to the law but emphasized the importance of striking a proper balance between legitimate privacy concerns and equally legitimate law enforcement information needs. In this regard, we were particularly concerned that present law provides no means for IRS to initiate disclosure of information it obtains from the taxpayer regarding the commission of non-tax crimes. We therefore recommended that the Congress authorize IRS to disclose such non-tax criminal information by obtaining an ex parte court order.

As a result of the hearings, identical bills (S. 2402 and H.R. 6826), which would significantly revise the disclosure statute, were introduced in the Senate and the House.

The Administration is also developing a position on the disclosure issue and plans to submit its own legislative proposal in the near future.

In our March 1979 report and December 1979 testimony, we also pointed out that the third-party summons provisions of the 1976 Tax Reform Act were impeding investigative efforts by causing unreasonable delays in granting IRS access to information it needed to enforce the tax laws. The provisions require IRS to notify affected taxpayers after issuing a summons to a third-party recordkeeper. The taxpayer has 14 days within which to stay compliance by merely notifying the person summoned not to comply. IRS must then initiate court action to enforce the summons. The taxpayer can, but is not required to, intervene in the court proceedings. As a result, many individuals stay compliance to delay ongoing tax investigations.

We recommended that the Congress consider adopting the stay of compliance procedures contained in section 1105 of the Right to Financial Privacy Act of 1978. That act calls for an individual to be notified when a Government agency seeks access to financial records by means of an administrative summons. However, at the outset, the affected individual must specify to a court, in writing, why he or she objects to the summons, thus removing the incentive to stay compliance for delay purposes only. The Government must then file with the court its written justification for seeking the records. The law further authorizes the court to reach a decision based on the written affidavits.

As a result of the Senate Permanent Subcommittee's December 1979 hearings, a bill (S. 2403) was recently introduced in the Senate which basically adopts the stay of compliance procedures for IRS third-party summonses contained in the Right to Financial Privacy Act.

However, IRS, DEA, and Justice need not await legislative revisions before taking action to enhance their effectiveness in dealing with narcotics traffickers.

ADMINISTRATIVE CHANGES NEEDED TO ENHANCE THE GOVERNMENT'S NARCOTICS INVESTIGATIVE EFFORTS

These agencies can take certain administrative actions under present law which would lead to a more effective, coordinated Federal effort to immobilize the financial resources of narcotics traffickers. The remainder of my testimony deals with these actions.

DEA needs to make more effective use of asset forfeiture authority

First and foremost among administrative actions which these agencies should take involves DEA using asset forfeiture authority more effectively.

IRS has various means by which it can identify and collect taxes owed by narcotics traffickers on their illicit profits. In the last decade, however, DEA has been granted even broader powers to seek the forfeiture of the profit itself, as well as related assets.

Three Federal statutes allow for the forfeiture of traffickers' narcotics-related assets:

--The Continuing Criminal Enterprise statute (21 U.S.C. 848), part of the 1970 Controlled Substances Act, allows for forfeiture of profits obtained by an individual from the criminal enterprise, upon conviction.

--The Racketeer Influenced and Corrupt Organization statute (RICO) (18 U.S.C. 1961-64), part of the Organized Crime Control Act of 1970, allows for forfeiture, upon conviction, of profit, interest, or property acquired in violation of the RICO statute.

--Title 21, section 881 of the U.S. Code allows for civil forfeiture of vehicles, equipment, and other items used to facilitate controlled substance violations. In addition, since November 1978, this statute also provides for civil forfeiture of moneys or other things of value used in exchange for a controlled substance and all proceeds of that exchange.

However, as discussed in our March 1980 report on DEA's Central Tactical (CENTAC) program, despite the enormous amounts of illegally derived funds generated by narcotics trafficking organizations, few of their assets have been taken under the forfeiture statutes. With your permission, we would like to submit a copy of the report for the record.

The CENTAC program is DEA's premiere effort to develop conspiracy investigations of high-level narcotics traffickers. DEA determines whether an investigation should be done under the program and is responsible for controlling and coordinating such investigations. The targeted organization usually must be at the top of the criminal hierarchy, be susceptible to immobilization through conspiracy investigations, and have a broad span of drug distributing activities.

CENTAC teams are comprised of DEA headquarters and field personnel and, sometimes, staff from IRS, the U.S. Customs Service, and local police forces. From its inception in 1973 through 1979, CENTAC has completed 21 investigations of major trafficking organizations, which are described in our report. Although CENTAC investigative results have been impressive in terms of the number of high-level traffickers arrested and the stiff prison sentences they have received, the investigations have produced little in the way of forfeitures of illicitly derived assets. For example, five CENTAC investigations we reviewed in detail resulted in no asset forfeitures; yet the organizations involved had estimated annual total earnings of $10 to $35 million each.

The Federal Government has to make more effective use of existing forfeiture authority in order to successfully immobilize narcotics traffickers. To accomplish this, DEA must establish forfeiture as an operational goal and develop the financial investigative expertise necessary to make such cases. Federal prosecutors now lack experience in using the forfeiture statutes and consider their use time consuming. However, if DEA develops the financial expertise and generates more forfeiture cases, Federal prosecutors must be willing to prosecute narcotics traffickers under these statutes.

Decentralization of disclosure authority within IRS would speed handling of disclosure requests

Second, I would like to discuss administrative actions which IRS can take to speed up disclosures it makes in response to court orders and written head of agency requests, as well as the procedures IRS follows in disclosing information it uncovers concerning non-tax crimes.

Under present law, certain Federal agency heads can gain access to information IRS has collected from taxpayers, their records, or their representatives, by obtaining an ex parte Federal district court order. Similarly, certain Federal agency heads can gain access to information IRS has obtained from third parties by submitting a written request to the Secretary of the Treasury specifying the taxpayer's name and address, the tax periods involved, the statutory authority under which the agency head is proceeding, and the specific reason for needing the tax information.

As you can see in chart I before you (and in appendix I to my prepared statement), present IRS procedures require that a Federal agency head forward court orders and written requests for tax information to the Director of IRS' Disclosure Operations Division in Washington, D.C. Upon receipt, each request is assigned for processing to an operations analyst who sends a clearance request to the affected IRS district office. The district disclosure officer, who is responsible for processing the clearance request, initiates the gathering of the information and routes the request to district Examination, Collection, and Criminal Investigation Division personnel for review. Once the clearance information is received from the three Divisions, the district disclosure officer forwards it to the operations analyst in Washington, D.C., who prepares a draft authorization or declination letter. The Section Chief, Branch Chief, and Division Director, review the letter sequentially with the Division Director making the final decision. If the Division Director authorizes disclosure, an authorization letter is forwarded to the district disclosure officer, who is then free to disclose the requested information, assuming the district can locate that information.

We recently checked IRS' response time on court ordered disclosures and written tax information requests. Four IRS district offices--Jacksonville, Los Angeles, Manhattan, and Philadelphia--responded to court orders in an average of 30, 61, 77, and 50 calendar days, respectively. The same offices responded to written tax information requests in an average of 85, 68, 88, and 81 days, respectively. The average processing time for written requests is usually longer than for court-ordered disclosures because Justice Department attorneys often seek court ordered disclosure of tax returns while also requesting third-party tax information on an individual taxpayer.

In our view, district offices could respond faster to court orders and requests if IRS would decentralize its disclosure procedures under existing law. As depicted in chart II before you (and in appendix II to my prepared statement), Federal agency heads would forward court orders and written requests for tax information directly to the appropriate IRS district office. Once the district disclosure officer obtained clearance from district Examination, Collection, and Criminal Investigation Division personnel, the District Director, in consultation with the disclosure officer, could authorize disclosure where appropriate. If the disclosure is authorized, the information, if and when collected, could be disclosed immediately. However, we recommend that IRS national headquarters make the final determination when a District Director believes that compliance with a court order or disclosure request might endanger a confidential informant or impair a tax investigation.

Next, I would like to discuss IRS' centralized process for disclosing information it uncovers about non-tax crimes. As you can see in chart III before you (and in appendix III to my prepared statement), an IRS employee who discovers an indication of a non-tax crime forwards that information, through appropriate channels, to IRS' Disclosure Operations Division in Washington, D.C. A Division operations analyst reviews the information to determine whether it can be disclosed. Then the Section Chief, Branch Chief, and Division Director review the analyst's decision sequentially with the Division Director making the final determination as to whether the information can legally be disclosed. If the Division Director determines that the information was obtained from a third party, it is forwarded to the appropriate Federal agency head. Otherwise, it is retained in IRS' files.

Once again, we propose that IRS decentralize the authority to disclose information about non-tax crimes which it obtains from third parties. This could speed up the process, which takes 43 days on the average now, and encourage IRS employees to seek permission to make such disclosures. According to various IRS officials, the current process discourages employees from seeking permission to disclose information on non-tax crimes. They stated that IRS field employees perceive that information they forward to the national office for disclosure is just "filed." The facts do not support that perception. However, a decentralized disclosure process, such as the one depicted in chart IV before you (and in appendix IV to my prepared statement), could encourage additional disclosures of non-tax crime information already authorized by existing law.

IRS is currently studying its administrative process for initiating disclosure or responding to disclosure requests. We understand that the study will result in some streamlining. Basically, IRS should not incur any additional costs in decentralizing or streamlining its processes. IRS already has a disclosure officer in each district who, with minimal additional training, could assume the responsibilities presently carried out by headquarter's officials. This, in turn, would lessen the burden on IRS' national office, thus reducing administrative and personnel costs.

DEA and IRS need to improve joint investigative efforts against narcotics traffickers

The third administrative action I would like to discuss relates to improvements DEA and IRS can make in their joint investigative efforts against narcotics traffickers.

In accordance with a 1976 DEA/IRS agreement, DEA provides IRS with names and background information on high-level drug traffickers referred to as DEA class I violators. Although IRS gives high priority to evaluating those leads for their criminal and civil tax potential, that process has produced few tangible results. Criminal tax cases are complex in nature and therefore usually take several years to investigate and prosecute. By the time IRS develops a tax case on a class I violator, the violator often has been incarcerated for drug-related or other offenses. In such instances, the Justice Department generally will not prosecute the tax charges because of its dual prosecution policy, which I will discuss shortly.

During the 3 years ended June 30, 1979, IRS' evaluation of 792 DEA-provided leads resulted in 114 new criminal investigations. Fifty class I violators were already being investigated by IRS when it received the DEA information. Only 11 class I violators had been convicted on criminal tax charges as of December 1979.

In February 1980, to improve DEA/IRS joint efforts, DEA agreed to provide IRS the names and background information on class I and class II violators, and other selected targets who derive substantial income from narcotics activities. Although this agreement should improve the program to some extent, it does not address the timeliness problem. To be effective, IRS needs to learn the identities of DEA investigative targets as early as possible.

Justice's dual prosecution policy limits IRS efforts against narcotics traffickers

A fourth area in which administrative action is needed is Justice's dual prosecution policy.

Justice's policy provides that all offenses arising out of a single transaction, such as drug trafficking and evading taxes on the ensuing profits, should be tried together. The policy has particular impact in the narcotics area because violators often are arrested and convicted on a narcotics charge before IRS can fully develop the related tax case for prosecution. In such instances, Justice will usually decline to prosecute the person for violations of the tax laws. Thus, IRS would have wasted scarce investigative resources. Moreover, the dual prosecution policy also affects the extent to which IRS intitiates criminal tax investigations of narcotics traffickers since its district Criminal Investigation Division chiefs understandably are reluctant to invest scarce resources in cases which are not likely to be prosecuted.

An an alternative strategy to remedy this problem, Justice needs to develop a more flexible dual prosecution policy. Presently, Justice gives special consideration only to class I violators who receive prison sentences of less than 5 years on non-tax charges. However, in a case where Justice and DEA have not pursued asset forfeiture under the controlled substance laws and the trafficker's illicitly derived assets remain intact, flexibility to consider a subsequent prosecution for a tax violation might be desirable. We believe a policy that takes factors like these into account will place IRS in a better position to evaluate whether the criminal tax consequences of a narcotics case should be pursued.

IRS needs to streamline its grand jury approval process

The fifth area in which administrative action is needed is the cumbersome grand jury approval process, which I would now like to discuss.

The grand jury is a powerful investigative body which, from IRS' standpoint, can be particularly valuable in the narcotics area. A special agent assigned to a grand jury investigation seldom has to deal with disclosure, summons, or dual prosecution problems. However, it takes IRS a long time to approve an agent's participation in a grand jury.

Since passage of the Tax Reform Act of 1976, IRS and other law enforcement agencies have used the grand jury increasingly as a tool for joint investigation and prosecution because it has several advantages over the normal administrative process. Members of grand jury investigative teams representing IRS and other agencies can fully and rapidly interchange information to a degree not otherwise possible under normal administrative procedures. Also, tax evasion charges and other criminal charges can be developed simultanenously, thus avoiding the dual prosecution problem. A grand jury also has the benefit of subpoena power, which is not subject to the multiple restrictions and requirements imposed on IRS summonses.

As depicted in chart V before you (and in appendix V to my prepared statement), IRS' current procedures for approving participation in grand jury investigations are cumbersome and time-consuming. The process begins at the district level with receipt and evaluation of a Government attorney's grand jury request by an IRS special agent. The attorney's request then is forwarded--through the Director of the district's Criminal Investigation Division, the District Director, and the Regional

Commissioner--to the appropriate Regional Counsel for approval. If approved by the Regional Counsel, the request goes directly to the Justice Department's Tax Division for review. With Tax Division approval, a U.S. attorney or strike force attorney can initiate an investigation or integrate IRS agents into a grand jury investigation already in process.

We recently obtained limited statistics from IRS on the timeliness of the grand jury approval process. In IRS' Manhattan district and North Atlantic regional offices, an average of 131 calendar days were needed to process seven recent grand jury investigations approved as of February 29, 1980. On the average, the Regional Counsel used 61 of the 131 days. Similar overall statistics were not available from IRS' Philadelphia district and its Mid-Atlantic region. However, since 1977, the region alone required an average of 59 days to process grand jury requests, 52 of which were used by the Regional Counsel. Also, according to the Assistant Regional Commissioner for Criminal Investigations in the Mid-Atlantic region, the Regional Counsel takes from 1 to 4 months to review grand jury authorizations. Thus, the primary consumer of processing time seems to be the Regional Counsel.

Regional Counsel attorneys must perform a complex and painstaking analysis to determine whether a grand jury is necessary and appropriate. The attorneys seek to ensure that (1) the administrative process cannot develop the relevant facts within a reasonable period of time, (2) coordination of a tax investigation would be more efficient, and (3) the case has significant deterrent potential. While this analysis is necessary, too few attorneys presently are authorized to perform grand jury analyses in the Regional Counsel's office. For example, only two attorneys in the North Atlantic Regional Counsel's office have the authority to analyze grand jury requests. Therefore, they must review all grand jury requests emanating from 10 IRS district offices while carrying out their other responsibilities.

IRS is presently considering a revision to the grand jury review and approval process. The revision would delete the Regional Commissioner's review and substitute the District Counsel review for the existing Regional Counsel review.

IRS needs to use jeopardy and termination assessments more effectively

The last administrative action relates to IRS using its jeopardy and termination assessment powers more effectively.

The Internal Revenue Code provides that when the IRS determines that the collection of a tax may be in jeopardy, it may immediately assess and collect the tax--through seizure of property, if necessary. If the date for filing a return and paying income tax has not passed, a termination assessment may be made of the tax liability before the end of the tax year. If the due date for filing a return and paying the tax has passed, filing and payment is generally done purusant to a jeopardy assessment.

Between 1972 and 1974, IRS systematically used jeopardy and termination assessments against individuals suspected of, or arrested for, a drug law violation as part of its Narcotics Traffickers Program. In May 1974, however, due to alleged abuses of its assessment powers, IRS modified its criteria for using jeopardy and termination assessments against narcotics traffickers to assure that they were used only in cases with substantial and documentable tax violations. Then, in 1976, the Congress amended the law to afford taxpayers subjected to such assessments quicker judicial remedy than had previously been available. Also, in January 1977, the Supreme Court ruled that a valid search warrant was needed to seize a taxpayer's possessions on the taxpayer's private premises.

The change in law, together with IRS' revised criteria and the 1977 Supreme Court decision, led to a sharp decline in the use of these powerful tools. Total jeopardy assessments, after rising from 298 in fiscal year 1972 to 526 in fiscal year 1974, rapidly declined to 69 by the end of fiscal year 1979. Similarly, IRS made 5,311 total termination assessments during fiscal years 1972 to 1974, but it made only 756 during the next 5 years.

Although there was definite evidence that IRS had abused its assessment powers during the early and mid-1970s, the statistics indicate that IRS may have abandoned use of these powerful civil tax tools even in situations where it could legitimately and effectively use them.

We believe that IRS can make more effective use of its assessment powers and should increase their use under proper circumstances, subject to the legal and administrative safeguards I mentioned earlier. That this can be done has recently been demonstrated by IRS' Jacksonville district.

Recognizing the serious nature of the narcotics problem, the Jacksonville district has initiated major efforts against narcotics traffickers in recent years. In fiscal year 1979, for example, the district developed 1,730 tax fraud allegations on traffickers and evaluated 173 of those allegations in detail for criminal tax potential. Another 268 of the 1,730 allegations led to audits. Moreover, the district made 15 jeopardy assessments and 53 termination assessments. These civil tax actions enabled IRS to assess traffickers over $21 million in back taxes and penalties. In contrast, IRS' Manhattan district office made only 3 jeopardy and 3 termination assessment, involving a total of about $1 million, during fiscal year 1979.

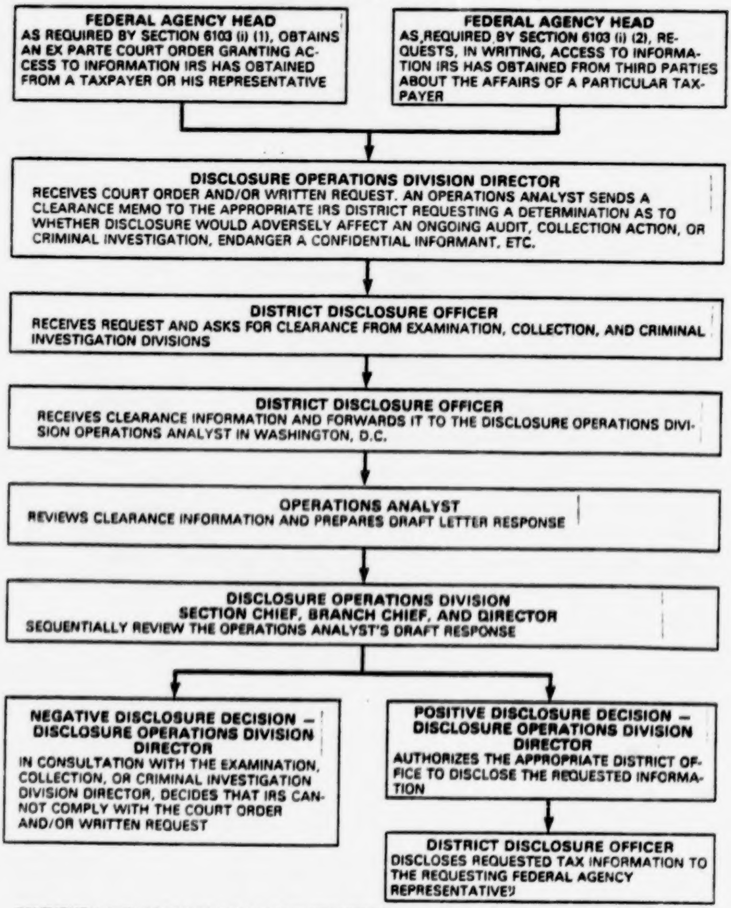
SUMMARY

In summary, a key way for the Federal Government to abate the flourishing narcotics trafficking business is to direct its coordinated efforts at immobilizing the financial resources which support that business. Yet, the Government has had only limited success in this regard because legal and administrative constraints have prevented IRS, DEA, and other agencies from effectively using and coordinating their unique skills, jurisdictions, and resources. Federal narcotics efforts could be improved if the Congress amends the disclosure and summons provisions of the 1976 Tax Reform Act. However, this alone will not resolve the problem. Federal agencies involved in narcotics enforcement need to take certain administrative actions. Most important among these is the need for DEA to make greater use of its asset forfeiture authority to curtail the financial resources of narcotics traffickers.

This concludes my prepared statement. We would be pleased to respond to any questions.

I

IRS ADMINISTRATIVE PROCESS FOR DISCLOSING INFORMATION UNDER I.R.C. 6103 i (1) AND (i) 2



FEDERAL AGENCY HEAD
AS REQUIRED BY SECTION 6103 (i) (1), OBTAINS AN EX PARTE COURT ORDER GRANTING ACCESS TO INFORMATION IRS HAS OBTAINED FROM A TAXPAYER OR HIS REPRESENTATIVE

FEDERAL AGENCY HEAD
AS REQUIRED BY SECTION 6103 (i) (2), REQUESTS, IN WRITING, ACCESS TO INFORMATION IRS HAS OBTAINED FROM THIRD PARTIES ABOUT THE AFFAIRS OF A PARTICULAR TAXPAYER

DISCLOSURE OPERATIONS DIVISION DIRECTOR
RECEIVES COURT ORDER AND/OR WRITTEN REQUEST. AN OPERATIONS ANALYST SENDS A CLEARANCE MEMO TO THE APPROPRIATE IRS DISTRICT REQUESTING A DETERMINATION AS TO WHETHER DISCLOSURE WOULD ADVERSELY AFFECT AN ONGOING AUDIT, COLLECTION ACTION, OR CRIMINAL INVESTIGATION, ENDANGER A CONFIDENTIAL INFORMANT, ETC.

DISTRICT DISCLOSURE OFFICER
RECEIVES REQUEST AND ASKS FOR CLEARANCE FROM EXAMINATION, COLLECTION, AND CRIMINAL INVESTIGATION DIVISIONS

DISTRICT DISCLOSURE OFFICER
RECEIVES CLEARANCE INFORMATION AND FORWARDS IT TO THE DISCLOSURE OPERATIONS DIVISION OPERATIONS ANALYST IN WASHINGTON, D.C.

OPERATIONS ANALYST
REVIEWS CLEARANCE INFORMATION AND PREPARES DRAFT LETTER RESPONSE

DISCLOSURE OPERATIONS DIVISION SECTION CHIEF, BRANCH CHIEF, AND DIRECTOR
SEQUENTIALLY REVIEW THE OPERATIONS ANALYST'S DRAFT RESPONSE

NEGATIVE DISCLOSURE DECISION — DISCLOSURE OPERATIONS DIVISION DIRECTOR
IN CONSULTATION WITH THE EXAMINATION, COLLECTION, OR CRIMINAL INVESTIGATION DIVISION DIRECTOR, DECIDES THAT IRS CANNOT COMPLY WITH THE COURT ORDER AND/OR WRITTEN REQUEST

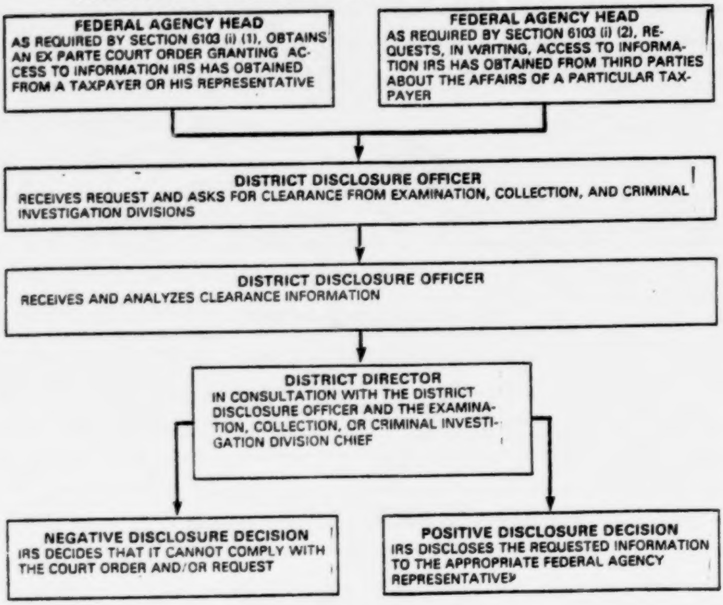
POSITIVE DISCLOSURE DECISION — DISCLOSURE OPERATIONS DIVISION DIRECTOR
AUTHORIZES THE APPROPRIATE DISTRICT OFFICE TO DISCLOSE THE REQUESTED INFORMATION

DISTRICT DISCLOSURE OFFICER
DISCLOSES REQUESTED TAX INFORMATION TO THE REQUESTING FEDERAL AGENCY REPRESENTATIVE[1]

[1] ALTHOUGH AUTHORIZED TO DISCLOSURE INFORMATION AT THIS POINT, DISCLOSURE MAY NOT BE FEASIBLE FROM AN ADMINISTRATIVE STANDPOINT. WHILE THE DISTRICT HAS BEEN GATHERING THE REQUESTED INFORMATION SINCE RECEIVING THE CLEARANCE REQUEST, THE INFORMATION GATHERING TASK CAN TAKE WEEKS OR MONTHS.

II

GAO'S PROPOSED REVISION TO THE IRS ADMINISTRATIVE PROCESS FOR DISCLOSING INFORMATION UNDER I.R.C. 6103 i (1) AND (i) 2


FEDERAL AGENCY HEAD
AS REQUIRED BY SECTION 6103 (i) (1), OBTAINS AN EX PARTE COURT ORDER GRANTING ACCESS TO INFORMATION IRS HAS OBTAINED FROM A TAXPAYER OR HIS REPRESENTATIVE
FEDERAL AGENCY HEAD
AS REQUIRED BY SECTION 6103 (i) (2), REQUESTS, IN WRITING, ACCESS TO INFORMATION IRS HAS OBTAINED FROM THIRD PARTIES ABOUT THE AFFAIRS OF A PARTICULAR TAXPAYER
DISTRICT DISCLOSURE OFFICER
RECEIVES REQUEST AND ASKS FOR CLEARANCE FROM EXAMINATION, COLLECTION, AND CRIMINAL INVESTIGATION DIVISIONS
DISTRICT DISCLOSURE OFFICER
RECEIVES AND ANALYZES CLEARANCE INFORMATION
DISTRICT DIRECTOR
IN CONSULTATION WITH THE DISTRICT DISCLOSURE OFFICER AND THE EXAMINATION, COLLECTION, OR CRIMINAL INVESTIGATION DIVISION CHIEF
NEGATIVE DISCLOSURE DECISION
IRS DECIDES THAT IT CANNOT COMPLY WITH THE COURT ORDER AND/OR REQUEST
POSITIVE DISCLOSURE DECISION
IRS DISCLOSES THE REQUESTED INFORMATION TO THE APPROPRIATE FEDERAL AGENCY REPRESENTATIVE[1]

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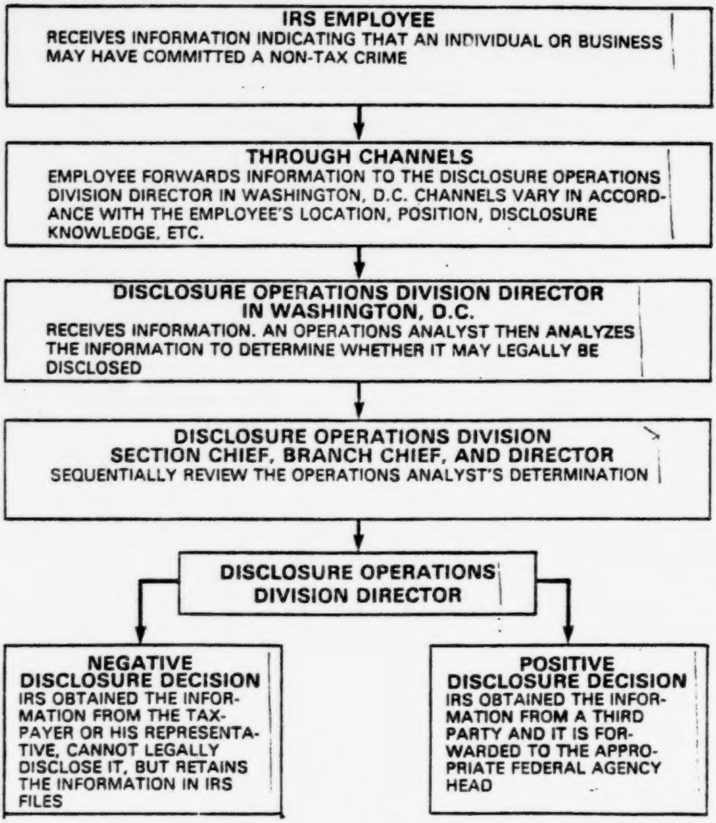
[1] WHILE THE DISCLOSURE OFFICER CAN DISCLOSE INFORMATION AT THIS POINT, THE AFFECTED IRS DIVISION MIGHT NEED WEEKS OR MONTHS TO GATHER ALL THE REQUESTED INFORMATION.

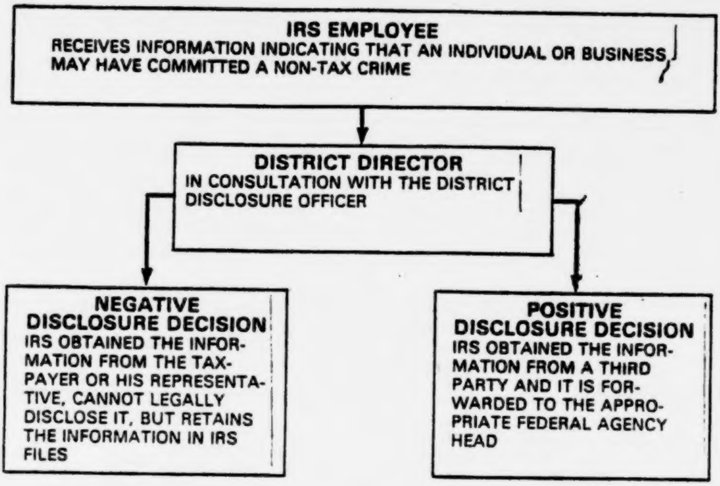
III

IRS ADMINISTRATIVE PROCESS FOR DISCLOSING INFORMATION UNDER I.R.C. 6103 (i) (3)


IRS EMPLOYEE
RECEIVES INFORMATION INDICATING THAT AN INDIVIDUAL OR BUSINESS MAY HAVE COMMITTED A NON-TAX CRIME
THROUGH CHANNELS
EMPLOYEE FORWARDS INFORMATION TO THE DISCLOSURE OPERATIONS DIVISION DIRECTOR IN WASHINGTON, D.C. CHANNELS VARY IN ACCORDANCE WITH THE EMPLOYEE'S LOCATION, POSITION, DISCLOSURE KNOWLEDGE, ETC.
DISCLOSURE OPERATIONS DIVISION DIRECTOR IN WASHINGTON, D.C.
RECEIVES INFORMATION. AN OPERATIONS ANALYST THEN ANALYZES THE INFORMATION TO DETERMINE WHETHER IT MAY LEGALLY BE DISCLOSED
DISCLOSURE OPERATIONS DIVISION SECTION CHIEF, BRANCH CHIEF, AND DIRECTOR
SEQUENTIALLY REVIEW THE OPERATIONS ANALYST'S DETERMINATION
DISCLOSURE OPERATIONS DIVISION DIRECTOR
NEGATIVE DISCLOSURE DECISION
IRS OBTAINED THE INFORMATION FROM THE TAXPAYER OR HIS REPRESENTATIVE, CANNOT LEGALLY DISCLOSE IT, BUT RETAINS THE INFORMATION IN IRS FILES
POSITIVE DISCLOSURE DECISION
IRS OBTAINED THE INFORMATION FROM A THIRD PARTY AND IT IS FORWARDED TO THE APPROPRIATE FEDERAL AGENCY HEAD

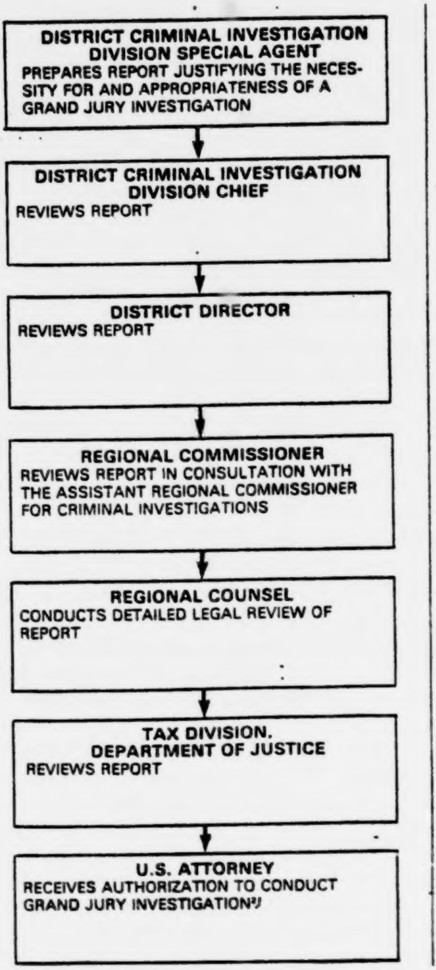
IV

GAO'S PROPOSED REVISION TO THE IRS ADMINISTRATIVE PROCESS FOR DISCLOSING INFORMATION UNDER I.R.C. 6103 (i) (3)


IRS EMPLOYEE
RECEIVES INFORMATION INDICATING THAT AN INDIVIDUAL OR BUSINESS MAY HAVE COMMITTED A NON-TAX CRIME
DISTRICT DIRECTOR
IN CONSULTATION WITH THE DISTRICT DISCLOSURE OFFICER
NEGATIVE DISCLOSURE DECISION
IRS OBTAINED THE INFORMATION FROM THE TAXPAYER OR HIS REPRESENTATIVE, CANNOT LEGALLY DISCLOSE IT, BUT RETAINS THE INFORMATION IN IRS FILES
POSITIVE DISCLOSURE DECISION
IRS OBTAINED THE INFORMATION FROM A THIRD PARTY AND IT IS FORWARDED TO THE APPROPRIATE FEDERAL AGENCY HEAD

V

ADMINISTRATIVE APPROVAL PROCESS FOR A TYPICAL IRS GRAND JURY INVESTIGATION[1]


DISTRICT CRIMINAL INVESTIGATION DIVISION SPECIAL AGENT
PREPARES REPORT JUSTIFYING THE NECESSITY FOR AND APPROPRIATENESS OF A GRAND JURY INVESTIGATION
DISTRICT CRIMINAL INVESTIGATION DIVISION CHIEF
REVIEWS REPORT
DISTRICT DIRECTOR
REVIEWS REPORT
REGIONAL COMMISSIONER
REVIEWS REPORT IN CONSULTATION WITH THE ASSISTANT REGIONAL COMMISSIONER FOR CRIMINAL INVESTIGATIONS
REGIONAL COUNSEL
CONDUCTS DETAILED LEGAL REVIEW OF REPORT
TAX DIVISION, DEPARTMENT OF JUSTICE
REVIEWS REPORT
U.S. ATTORNEY
RECEIVES AUTHORIZATION TO CONDUCT GRAND JURY INVESTIGATION[2]

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[1] EACH REVIEWER IS AUTHORIZED TO APPROVE OR DENY GRAND JURY AUTHORIZATION. DENIALS ARE NOT FORWARDED TO SUBSEQUENT REVIEWERS.

[2] IRS ALSO RECEIVES NOTIFICATION THAT THE TAX DIVISION HAS APPROVED THE GRAND JURY INVESTIGATION.

TOO FEW FINANCIAL INVESTIGATIONS

Mr. JONES. Mr. Chairman and members of the subcommittee, our testimony today deals with several specific actions needed to strengthen the ability of various agencies, particularly the Drug Enforcement Administration and the Internal Revenue Service, to deal with the narcotics problem.

Incarcerating major traffickers for long periods and causing forfeiture of their financial resources are key elements to successfully reducing the narcotics problem. This requires close interaction and coordination among the Federal law enforcement agencies, including DEA and IRS.

For various reasons, however, neither DEA nor IRS have performed many finance-oriented narcotics investigations.

Knowledge of money flows, along with other information is essential to identifying and immobilizing narcotics traffickers. Although DEA has the legal authority, under various U.S. Code sections, to seek forfeiture of traffickers' illegally derived assets, it does not have the extensive financial expertise needed to perform such investigations. IRS, on the other hand, has the financial expertise, and thus, can play an important role.

However, legal obstacles, little overall direction and changing priorities have hindered these and other agencies from implementing a well-integrated, balanced, and coordinated approach to the problem and from successfully immobilizing the financial resources of high-level traffickers. Legislative and administrative changes are needed to improve the situation.

LEGISLATIVE CHANGES NEEDED

From a legislative standpoint, the Congress needs to amend the disclosure and summons provisions of the 1976 Tax Reform Act.

In our March 1979 report on the effects of the disclosure and summons provisions of the 1976 act, we pointed out that the disclosure provisions had afforded taxpayers increased privacy over information they provide IRS. At the same time, however, they have had some adverse impact on coordination between IRS and other law enforcement agencies.

In December 1979, the Senate Permanent Subcommittee on Investigations held hearings on the narcotics trafficking problem and concluded that the provisions had seriously impeded Federal efforts to deal with the problem.

During the hearings, we supported the need to revise the law but emphasized the importance of striking a proper balance between legitimate privacy concerns and equally legitimate law enforcement information needs. In this regard, we were particularly concerned that present law provides no means for IRS to initiate disclosure of information it obtains from the taxpayer regarding the commission of nontax crimes. We recommended that the Congress consider authorizing IRS to disclose nontax criminal information by obtaining an ex parte court order.

As a result of the hearings, identical bills, which would significantly revise the disclosure statute, were recently introduced in the Senate—S. 2402—and the House of Representatives—H.R. 6826. The administration is also developing a position on the disclosure issue and plans to submit its own legislative proposal in the near future.

In our March 1979 report and December 1979 testimony, we also pointed out that the third-party summons provisions of the 1976 Tax Reform Act were impeding investigative efforts by causing unreasonable delays in granting IRS access to information it needs to enforce the tax laws.

Under the act, the taxpayer can stay compliance by merely notifying the third-party recordkeeper not to comply; and then is not required to intervene in any related court proceedings initiated by IRS.

We recommended that the Congress consider adopting the stay of compliance procedures contained in section 1105 of the Right to Financial Privacy Act of 1978. That act calls for an individual to be notified when a Government agency seeks access to financial records by means of an administrative summons.

However, at the outset, the affected individual must specify to a court, in writing, why he or she objects to the summons thus removing the incentive to stay compliance for delay purposes only.

As a result of the Senate Permanent Subcommittee's December 1979 hearings, a bill—S. 2403—was recently introduced in the Senate which basically adopts the Right to Financial Privacy Act stay of compliance procedures.

ADMINISTRATIVE REFORMS NEEDED

However, the Tax Reform Act is only one of many impediments affecting Federal narcotics efforts. Under existing law, IRS, DEA, and the Justice Department can take certain administrative actions to improve their cooperation and coordination on narcotics matters.

DEA'S ASSET FORFEITURE AUTHORITY LITTLE USED

Chief among these actions is the need for DEA to make greater use of its asset forfeiture authority by focusing more on the financial transactions connected with the narcotics business.

First, although IRS has various means by which it can identify and collect taxes owed by narcotics traffickers on their illicit profits, DEA has even broader powers. In the last decade, three Federal statutes have been enacted which authorize DEA to seek the forfeiture of the profit from the narcotics trade, as well as related assets. These are the Continuing Criminal Enterprise Statute, the Racketeer Influenced and Corrupt Organization Statute, and a provision that is already in title XXI of the U.S. Code.

However, as discussed in our March 1980 report on the Central Tactical program of the DEA—we refer to it as CENTAC—despite the enormous amounts of illegally derived funds generated by narcotics trafficking organizations, few assets have been taken under the forfeiture statutes.

With your permission, we would like to submit a copy of the report for the record.

Senator CHILES. It will be accepted for the record.

[The information follows:]

GENERAL ACCOUNTING OFFICE
REPORT TO THE ATTORNEY GENERAL

THE DRUG ENFORCEMENT ADMINISTRATION'S CENTAC PROGRAM--AN EFFECTIVE APPROACH TO INVESTIGATING MAJOR TRAFFICKERS THAT NEEDS TO BE EXPANDED

DIGEST

The 1979 Federal Strategy for Drug Abuse and Drug Traffic Prevention states that Federal domestic drug law enforcement should be focused on major drug trafficking organizations. The Central Tactical program was established by the Drug Enforcement Administration to do just that. Under the program, large, centrally controlled, many-faceted, interregional, conspiracy investigations of major drug organizations are conducted.

The program has proven to be an effective method of investigating and prosecuting large numbers of high level narcotics traffickers and should be expanded. Using few resources, Central Tactical investigations have accounted for a high number of major trafficker arrests. But Drug Enforcement Administration officials say the program size is optimum. Data to support or refute the agency's position is limited.

The Drug Enforcement Administration, therefore, needs to conduct a rigorous reexamination of its position to serve as a basis for either reallocating existing resources or justifying to the Congress its need for additional resources.

The Federal strategy also stresses investigations which lead to forfeiture of drug traffickers' assets to immobilize major drug organizations. Central Tactical investigations have had minimal success in this area. Major changes are needed to improve the Government's ability to immobilize traffickers by taking away the financial reward from illicit drug dealings.

CENTRAL TACTICAL UNITS ARE SUCCESSFUL

Initiated in 1973, the Central Tactical program has included conspiracy investigations of 21 major drug trafficking organizations. The program has been praised by officials in the criminal justice system. Even though it comprises only a small portion of the Drug Enforcement Administration's enforcement effort, it has resulted in the arrest and prosecution of many top narcotics violators. For example:

--Central Tactical investigations active during the 3-year period (1976-1978) have resulted in indictments of 731 traffickers, of which 260, or over 36 percent, were the highest level violators. Overall, only 12 percent of total agency arrests are high level violators. (See p. 4.)

--Central Tactical units have been responsible for over 12 percent of all the high-level violators arrested from 1976 to 1978, while using less than 3 percent of the Drug Enforcement Administration's enforcement resources. (See p. 4.)

--Federal prosecutors commented that the Central Tactical units generated some of the Drug Enforcement Administration's best investigative efforts, resulting in convictions and lengthy prison sentences for trafficking organizations leaders. (See p. 5.)

EXPANSION IS IN ORDER

The Drug Enforcement Administration has identified over 100 leaders of major organizations for priority enforcement action. According to Drug Enforcement Administration officials, probing these organizations will require large multiregional conspiracy investigations. (See p. 7.)

Given the success of the Central Tactical units and the need for more multiregional conspiracy investigations, the expansion of the Central Tactical program is warranted. Such expansion would be consistent with the Attorney General's policy guidelines. For fiscal year 1980, he directed the Drug Enforcement Administration to increase its emphasis on major trafficking organizations through Central Tactical Unit operations and the development of major conspiracy cases. However, Drug Enforcement Administration officials said the current size of the program is optimum given existing enforcement resources and required commitments, and its preference for regionally controlled investigations focused on major traffickers. (See p. 8.)

Data needed to support or refute the agency's position is limited. Data available suggests that commitments to investigate other agencies' referrals are largely unproductive. The Drug Enforcement Administration has greater flexibility to reallocate resources to Central Tactical investigations than it admits. Regionally controlled investigations work against one of the major benefits of Central Tactical investigations--effective investigations of the full scope of major traffickers' activities. Until the agency rigorously evaluates the benefits of its various programs, it will not be in a position to know whether to reallocate resources or be able to justify additional resources for Central Tactical-type investigations. (See pp. 8 to 13.)

RISK OF ECONOMIC LOSS MUST BE INCREASED

Even though the forfeiture of drug traffickers' assets is an integral part of the Government's strategy to immobilize trafficking organizations, the Central Tactical program has had minimal success in this area. Although many high-level drug dealers have received substantial prison sentences, in general they have been able to retain their drug-related assets. The estimated annual revenues of the five criminal organizations probed by the Central Tactical units GAO studied in detail totalled at least $65 million, but the Government obtained very little of those revenues. Forfeitures of traffickers' drug-related assets were insignificant and only 10 percent of the 187 convicted traffickers received fines which totalled only $118,000.

The lack of success in obtaining traffickers' assets can be attributed, at least in part, to three interrelated causes.

--The Drug Enforcement Administration lacks financial investigative expertise. (See p. 15.)

--Many U.S. attorneys are inexperienced in the use of forfeiture statutes, or consider prosecution under these statutes to be too timeconsuming. (See p. 16.)

--Asset seizures were not established as a goal in the Central Tactical unit's operational plans. (See p. 18.)

In addition, the Drug Enforcement Administration has requested only a limited amount of tax information for narcotics investigations. (See p. 19.)

The Drug Enforcement Administration's investigative personnel do not have backgrounds in financial analysis. Unlike other investigative agencies which have many agent/accountants, DEA has none. Because of budget limitations, the Drug Enforcement Administration is unlikely to increase its staff with a significant number of financial specialists. (See p. 15.)

One of the key problems identified at a September 1978 Drug Enforcement Administration conference on the use of financial intelligence in narcotics investigations was that many U.S. attorneys had limited knowledge of or tended not to use available criminal and civil forfeiture authorizations. In addition, Federal prosecutors stated that because asset forfeiture cases were so timeconsuming, it may be more efficient to use their time on additional cases rather than attempt forfeiture of the assets of a trafficker already convicted and in prison. (See p. 16.)

Plans and proposals for implementing the five Central Tactical units reviewed did not specifically provide for seizure and forfeiture of traffickers' assets. The combination of the Drug Enforcement Administration's lack of expertise and the U.S. attorney's unwillingness to use forfeiture statutes goes a long way to explain why the five Central Tactical units neither geared up to nor achieved any significant seizures of traffickers' assets. (See p. 18.)

RECOMMENDATIONS

GAO recommends that the Attorney General direct the Administrator of the Drug Enforcement Administration to evaluate the effectiveness of the various methods used to investigate major traffickers with the aim of determining whether redirecting enforcement resources from less productive approaches is feasible. (See p. 13.)

To increase the use of financial analysis and obtain forfeiture of traffickers' drug-related assets, GAO makes two additional recommendations to the Attorney General. (See p. 20.)

CHAPTER 1

INTRODUCTION

Illegal drug trafficking is a multibillion dollar business involving many large national and international organizations. Millions of dollars are spent annually by law enforcement agencies on supply reduction efforts.

The U.S. drug enforcement policy, as set forth in the 1979 Federal Strategy for Drug Abuse and Drug Traffic Prevention, stipulates that Federal investigative agencies should place primary emphasis on investigating, arresting, and providing sufficient evidence to prosecute major violators of drug and drug-related statutes, focusing on those traffickers at the top of the organizations. The Federal strategy also stresses investigations which lead to forfeiture of the financial assets of drug traffickers as a means to immobilize trafficking organizations. The Drug Enforcement Administration (DEA) in the Department of Justice is the lead agency for enforcement of Federal drug laws.

THE CENTAC PROGRAM

Major narcotics trafficking organizations are multimillion dollar operations whose illegal activities transcend State and national boundaries. Because high-level violators are isolated from drug transactions, experience has demonstrated that often the only way to proceed against these violators is through conspiracy investigations. The premier effort to develop conspiracy investigations of high-level narcotics violators has been the Central Tactical (CENTAC) program. From inception of the program in 1973 through 1979, 21 investigations of major trafficking organizations had been made. Ten investigations had been directed against heroin distribution organizations, with the remainder involving various other drugs. Appendix I describes these 21 investigations.

DEA headquarters, with input from its five regional offices and headquarters intelligence units, determines whether an investigation should be done under the CENTAC concept. For a CENTAC to be established, the targeted organization

--must be at the top of the criminal hierarchy and capable of distributing major quantities of illegal drugs,

--must be susceptible to immobilization only through conspiracy investigations, and

--must have activities which span more than one DEA region and are clearly beyond the capability of one region to handle.

Upon approval of a CENTAC investigation, DEA prepares an operational plan which includes information on personnel and resources to be used, investigative methods to be employed, and major objectives to be achieved. Personnel from DEA's headquarters and field offices are assigned to the CENTAC. In addition, staff from the Internal Revenue Service (IRS), U.S. Customs Service, and local police forces have been assigned to some CENTAC investigations. Overall administrative control and operational coordination is the responsibility of the CENTAC office within DEA headquarters' Office of Enforcement in Washington, D.C. Prosecutions are coordinated by the Department of Justice's Criminal Division.

CHAPTER 2

WAYS TO EXPAND CENTAC PROGRAM NEED TO BE FOUND

The CENTAC program has proven to be a successful method of arresting and prosecuting large numbers of high-level narcotics traffickers. Using few DEA resources, CENTAC investigations have accounted for a high number of major trafficker arrests. Federal agents and prosecutors have praised the quality of CENTAC investigations and the resulting prosecutions. Yet, no expansion of the CENTAC program is planned.

DEA officials, citing existing resource levels, the agency's commitments to other law enforcement agencies, and DEA's management philosophy that its regional offices should control most investigations which focus on major traffickers, maintain that the CENTAC program is at its optimum level.

There is a paucity of data currently available to confirm or refute DEA's position. The need for more CENTAC-type investigations is clear, however, and existing data suggests that DEA has greater flexibility to redirect resources than it admits. DEA management needs to conduct a rigorous reexamination of its position to serve as a basis for either reallocating existing resources or justifying to the Congress its need for additional resources.

CENTAC RESULTS ARE IMPRESSIVE

The results of CENTAC investigations have been impressive, not only in terms of the number of high-level traffickers arrested, but also the sentences the traffickers have received. In view of the fact that these results were achieved using only a small fraction of DEA's overall resources, they are particularly noteworthy.

Many major violators have been arrested

From January 1976 (the earliest date for which statistics are available) through December 1978, 10 CENTAC investigations resulted in indictments of 731 traffickers. A breakdown of the class of violators 1/ indicted is shown below.

1/DEA places violators into one of four classes according to the importance of their trafficking activities. The highest designation is class I.

CENTAC Results: Violators Indicted

Class of violator	Number	Percent of total
I	260	36
II	134	18
III	243	33
IV	94	13
Total	731	100

A comparison of CENTAC results with DEA's overall record adds greater signficance to CENTAC achievements. As shown, 36 percent of the indictments resulting from the 10 CENTAC investigations were class I violators. Overall, only 12 percent of DEA's arrests 1/ initiated by DEA are class I violators.

CENTAC results have been particularly impressive in light of the small percentage of DEA's enforcement effort CENTAC comprised. Since January 1976, less than 3 percent of DEA's enforcement personnel have been assigned to CENTACs, and only 1.3 percent of total expenditures for information and evidence were for CENTAC investigations. Yet, CENTAC accounted for over 12 percent of all class I violators arrested by DEA. Of 2,116 class I violators arrested by DEA during the 3-year period 1976 to 1978, 260 were the result of the 10 CENTAC investigations operational during that time.

CENTAC results are also more impressive than those of DEA/Federal Bureau of Investigation (FBI) task forces. Even though staffed with 21 DEA special agents (about 1 percent of DEA's total) and an equal number of FBI agents, few class I violator arrests have been made. During the 18 months, from October 1977 to May 1979, the 3 DEA/FBI task force investigations resulted in indictments of 12 class I traffickers.

Many trafficking organization leaders received long prison sentences

Many of the leaders of the five drug trafficking organizations investigated by the CENTAC units we studied in detail received lengthy prison sentences and special parole terms. 2/ For example:

1/CENTAC data is for individuals indicted rather than arrested. DEA officials said this would tend to slightly deflate the CENTAC data relative to DEA total arrests.

2/Special parole terms are mandated by the Controlled Substances Act for most defendants sentenced to a term of imprisonment for trafficking. Essentially, it increases the amount of time a defendant is monitored by probation officers after a prison sentence.

Trafficker	Drug	Sentence Prison	 Special parole
Valenzuela	Heroin	Life	-
Vila	Heroin	30 years	-
Melendez-Pereira	Heroin	15 years	5 years
Watson	Heroin	15 years	20 years
Lugo	Heroin	15 years	20 years
Jones	PCP	10 years	-
Gaxiola	Heroin	8 years	15 years

OFFICIALS PRAISE THE PROGRAM

All of the 51 officials we held discussions with, including DEA agents and management officials and U.S. attorneys, commended the CENTAC program. These officials stated that the program represented one of DEA's best effor to investigate major narcotics traffickers.

Federal prosecutors cite improved case quality

We talked to 10 U.S. attorneys, assistant U.S. attorne and the chiefs of major drug prosecution units in 4 judicia districts who had been involved in CENTAC prosecutions. Al praised the CENTAC method of investigating major violators, citing better investigative and prosecutorial coordination and improved evidence gathering as CENTAC advantages.

One of the most frequently cited benefits of CENTAC investigations by Federal prosecutors is the improved case presented to the court. By probing an entire interregional trafficking organization and presenting the investigation results in their entirety, Federal prosecutors better demonstrate to the judge and jury the magnitude of the illegal activities conducted by the illicit organization. Federal prosecutors familiar with the trial of Jose Valenzuela, for example, said that the scope of the CENTAC investigation enabled the prosecutors to demonstrate the extensive drug empire, including drug amounts and resulting financial gains, of the Valenzuela organization. In their opinion, this presentation was instrumental in obtaining Valenzuela's conviction and life sentence.

Overall, Federal prosecutors said that DEA should be conducting more investigations like those done under the CENTAC program.

DEA officials note advantages of the program

All of the 16 DEA agents and 25 management officials we held discussions with in 3 of DEA's 5 regions and at the headquarters in Washington praised the CENTAC program. More than 80 percent (34) of these officials believed that CENTAC investigations were the best way to probe large interregiona drug trafficking organizations.

All 16 DEA agents who had been assigned to CENTAC units believed that the CENTAC approach offered many advantages over other types of DEA investigations. Specifically, these agents said that the dedication of the agent team to one investigation and the ease of gathering corroborating evidence in scattered geographical areas were two reasons why the CENTAC method was desirable. For example:

- --A supervisory agent from New York, noting the complexity of a conspiracy investigation, said CENTAC units have agents assigned ". . . who are familiar with the case and are able to travel wherever they need to obtain information . . . Continuity is achieved by assigning the same agents to the entire investigation."
- --An agent from San Diego commenting on the CENTAC investigation he supervised said that "agents were able to interview all witnesses themselves rather than relying upon the agents in other offices to do so."

Overall, DEA agents and management officials said the complexity of conspiracy cases, coupled with the need to gather evidence from a wide geographic area, makes CENTAC-type investigations a must for probing many of the highest level drug trafficking organizations. They explain that the CENTAC investigative method allows investigators to more efficiently tie together evidence gathered from various locations--a necessity for conspiracy investigations.

MANY MULTIREGIONAL CONSPIRACY INVESTIGATIONS REQUIRED TO ATTACK THE HIGHEST LEVEL VIOLATORS

Most of the highest level narcotics violators identified by DEA belong to trafficking organizations whose illegal activities cover wide geographic areas. DEA officials acknowledge that probing these organizations will require CENTAC-type investigations.

DEA identified over 6,200 class I narcotic traffickers. From these major traffickers, DEA's Office of Intelligence determined that 119 violators head the top narcotics trafficking organizations. These violators were identified as a guide to achieve maximum results in the deployment of DEA's intelligence and enforcement personnel. Nearly all of these top violators head highly mobile organizations whose illegal activities are of wide geographic scope, often covering two or more of DEA's regions.

DEA officials said that probing major trafficking organizations, such as those on the top violators lists, often requires well-coordinated interregional conspiracy investigations. In responding to a Senate Appropriation Committee question on the CENTAC program in April 1979, DEA said that to investigate many large criminal organizations it is necessary to coordinate resources from a central point. DEA told the Committee: "It has been found that CENTAC units have a unique ability to respond effectively to highly mobile national and international organizations."

DEA HAS LIMITED PROGRAM EXPANSION

Given the success of the Central Tactical units and the need for more multiregional conspiracy investigations, the expansion of the program is warranted. Such expansion would be consistent with the Attorney General's policy guidelines for the fiscal year 1980 budget. He directed DEA to "increase its emphasis on major trafficking organizations through Central Tactical Unit (CENTAC) operations and the development of major conspiracy cases."

However, DEA officials said the current size of the CENTAC program is optimum given existing enforcement resources, required commitments, and their preference for regionally controlled investigations which focus on major drug traffickers.

DEA says limited resources and other commitments restrict program expansion

DEA officials, while acknowledging the value of CENT type investigations, say that expansion of the CENTAC pro beyond its current level is not possible. In responding question on CENTAC program expansion raised by the Senate Appropriations Committee in April 1979, DEA said "Any inc in activity above the current level will necessitate more resources. There are no additional resources available through reprogramming in this budget request."

DEA officials explained that their ability to reallo enforcement resources to the CENTAC program is restricted various legal and administrative commitments, including (the legal requirement to investigate referrals from other Federal agencies, particularly at the borders, and (2) th administratively mandated commitment to State and local l enforcement coordination efforts.

Investigations of other agencies' referrals largely unproductive

DEA's requirement to investigate other agency referr and their commitment to State and local coordination effo do not involve or result in many major violator investigations. In our report, "Illegal Entry at the United State Mexico Border--Multiagency Enforcement Efforts Have Not B Effective in Stemming the Flow of Drugs and People" (GGD-78-71, Dec. 2, 1977), we noted that less than 2 percent of the cases involved major violators, and only 8 per of the investigations led to the identification of higher level violators.

More recently, DEA management in South Florida told there was a large increase in the number of other Federal agencies' referrals associated with the area's large drug increase. These cases generally involved minor trafficke and hampered DEA's ability to devote more resources to major conspiracy investigations.

DEA officials said their commitment to coordinate wi State and local law enforcement agencies, such as assignments of personnel to State and local task forces, also limits their ability to devote more resources to investigations of high level traffickers. In our report "Gains Made in Controlling Illegal Drugs, Yet the Drug Trade Flourishes," (GGD-80-4, Oct. 25, 1979), we reported that some of the DEA/State and local task forces established t foster coordination were concentrating their efforts on low-level violators.

DEA can reallocate other resources to CENTAC-type investigations

DEA management has greater flexibility to reallocate resources to CENTAC-type investigations than it admits. In 1979, about 12 percent of their resources was expended on referrals from other agencies; about 10 percent was expended on Federal/State and local task forces; and the remainder, 78 percent of DEA's resources, was devoted to self-initiated investigations. This high level of discretionary resources suggests that resources could be made available for CENTAC investigations. This is particularly true in light of the fact that much of the resources devoted to self-initiated investigations are targeted at relatively low level traffickers. About 30 percent of the resources worked on investigations in which no level I or II traffickers were even suspected of being involved.

DEA prefers regionally controlled investigations

DEA's management philosophy dictates that most investigations be controlled by its regional offices. DEA officials told us that, while the CENTAC program has been successful, DEA regionally controlled programs to attack major traffickers also have been successful. However, little data is available to confirm or refute DEA's position. Its management philosophy of regionally controlled investigations tends to work against one of the major benefits of CENTAC--effective investigations of the full scope of major traffickers activities that cross regional lines.

Regionally controlled investigations work against CENTAC expansion

DEA officials point out that one of the benefits of the CENTAC program was to show the regions how to undertake complex conspiracy cases. And, according to DEA officials, since CENTAC program initiation in 1973, the regions have been conducting considerably more complex conspiracy cases. The officials also noted that the 1978 consolidation of DEA's regions from 13 to 5 expanded DEA's regional boundaries. This, in turn, makes it easier for one region to investigate trafficking organizations whose illegal activities encompass large geographic areas.

Although it is true that the larger regions may facilitate investigations of larger trafficking organizations, most of the top level organizations identified by DEA have activities that span two or more of DEA's new expanded regions. The ability of the regions to effectively run investigations involving more than one region is open to question.

Some CENTAC investigations have been controlled by a DEA regional office rather than the CENTAC office in headquarters. Discussions with agents assigned to these investigations and U.S. attorneys indicated that these regionally controlled CENTAC investigations were not as well run. Coordination between DEA's regions and between the CENTAC unit and the U.S. attorney's office was not as good, and the lines of authority and responsibility were not as clear.

Although over 100 major trafficker organizations have been identified by DEA, many DEA officials expressed the opinion that it would be inefficient to target these organizations for investigations until their involvement in trafficking is established through investigations of lower echelon organization members--a bottoms-up approach. DEA believes that the regions are more familiar with local trafficking patterns and methods and can better direct investigations by using information gained from lower level traffickers and then working up to the high-level violators.

Although the merits of this rationale is not being challenged, it contrasts sharply with the Government's approach to other criminal activity. The organized crime strike force and the FBI's Top Thief program, for example, both are premised on the belief that targeting suspected criminal organizations for investigation will have greater impact than investigating such organizations only when their link to specific crimes has been established.

Limited data for judging success of regionally controlled investigations

DEA officials told us that, while the CENTAC program has been successful, DEA regionally controlled programs have also successfully attacked major violators. They noted that increasing amounts of resources are being devoted to conspiracy investigations of high-level drug organizations. Mobile and special task forces and regional conspiracy units are just some of the examples of programs that have been established to focus on major violators. DEA, however, has only limited information on the costs or results of specific types of investigations.

DEA statistics on total arrests show that the number of class I arrests have remained relatively constant into 1979. The chart on the following page shows DEA arrest statistics over the past several years.

DEA Domestic Arrests
(note a)

Class of violator	1976	1977 (note b)	1978	1979 (note c)
I	922	649	545	426
II	730	546	401	226
III	3,648	3,260	2,720	1,476
IV	843	1,942	1,306	671
Total	6,143	6,397	4,972	2,799
Percent class I violator	15	10	11	15

a/Data includes CENTAC arrests. (1976-78 CENTAC arrests are shown on p. 4.)

b/The decline in class I and II arrests from 1976 to 1977 is partially attributable to more stringent classification adopted in November 1976.

c/1979 arrests are for the first 6 months: January to June 1979.

DEA officials also pointed out that the percentage of class I traffickers arrested does not indicate the level of effort they are directing toward those violators. They explained that many minor violator arrests are byproducts of class I violator investigations. For example, 47 percent of its arrests during the 12 months ending June 30, 1979, resulted from class I violator investigations. While significant, this still means that more than 50 percent of DEA's arrests result from investigations directed at less significant violators.

DEA does not accumulate cost and outcome data that can be used to evaluate specific kinds of investigative methods. As noted earlier in this chapter, 78 percent of DEA criminal investigative staff time is charged to DEA initiated cases. Nearly all 1/ of DEA's major programs directed at high-level violators (i.e., mobile task forces, special task forces, CENTACs, regional conspiracy units, etc.) are included in this total. Because costs and results of these programs were not accumulated by program, adequate analysis of the effectiveness of specific investigative programs was not possible.

In addition, DEA does not have adequate data on the disposition of arrested traffickers to help evaluate the effectiveness of investigative methods. DEA's system for accumulating this information is incomplete and contained information on only one-half of the CENTAC defendants who had been sentenced.

CONCLUSIONS

The CENTAC program has been successful, and program expansion is warranted. However, this is not likely to occur given DEA's belief that the program is at its optimum level. This may be correct. However, until DEA rigorously evaluates the benefits of its various programs, it will not be in a position to know whether to reallocate resources or to be able to justify additional resources for CENTAC or CENTAC-type investigations.

RECOMMENDATION TO THE ATTORNEY GENERAL

We recommend that the Attorney General direct the Administrator of DEA to evaluate the effectiveness of the various methods used to investigate major traffickers with the aim of determining whether redirecting enforcement resources from less productive approaches is feasible.

CHAPTER 3

ECONOMIC INCENTIVE MUST BE ATTACKED

Although the forfeiture of drug traffickers' assets is an integral part of the Government's strategy to immobilize trafficking organizations, CENTAC has had minimal success in this area.

1/DEA/FBI task force costs and resulting arrests are accumulated separately.

Even though many high-level traffickers prosecuted as a result of CENTAC investigations received substantial prison sentences, their drug-related assets were, in general, not forfeited to the United States. If traffickers are to be immobilized and would-be traffickers discouraged, more must be done to reduce the financial reward for illicit drug dealings. The lack of success of the five CENTAC units reviewed in obtaining drug traffickers' assets can be attributed, at least in part, to three interrelated causes.

--DEA did not have the expertise necessary to develop financial cases.

--Federal prosecutors were inexperienced or unwilling to use Federal statutes to obtain forfeiture of illegally generated assets.

--Asset seizures were not established as a goal in the CENTAC's operational plans.

Major changes are needed to improve the Government's ability to immobilize trafficking organizations.

ONLY SMALL AMOUNTS OF TRAFFICKERS' FUNDS ARE TAKEN

Despite the enormous amounts of illegally derived funds generated by illicit drug organizations, few assets have been taken from the organizations. Although the estimated annual earnings of the five trafficking organizations investigated by the five CENTACs we reviewed in detail ranged from $10 to $35 million, and each had been operating for many years, the CENTAC units made no concerted effort to immobilize the organizations through asset forfeitures.

Court imposed fines have also been extremely limited. For example, in the 5 CENTACs we reviewed, less than 10 percent (18) of the 187 sentenced traffickers were fined, and the fines totalled only $118,000.

The chart below demonstrates the relatively small amount of money taken from the trafficking organizations.

Assets Taken From Traffickers

Trafficking organization	Annual estimated revenues	Traffickers convicted	Total fines	Asset forfeitures (note a)
LSD	$35 million	5	$ 24,000	0
Heroin	$10-16 million	43	0	0
PCP	$10 million	25	$ 34,000	0
Heroin	$10-16 million	69	$ 55,000	0
Heroin	(Unknown)	45	$ 5,350	0
Total	$65-$77 million	187	$118,350	0

a/According to DEA officials, small amounts of cash, vehicles, and laboratory equipment may have been seized and subsequently forfeited in civil proceedings under authority granted in 21 U.S.C. 881. However, DEA does not accumulate this information.

DEA LACKS THE EXPERTISE TO DEVELOP CASES TO OBTAIN FORFEITURE OF TRAFFICKERS' ASSETS

Narcotics investigations involving financial analysis have been highly touted for over 3 years. However, these investigations have been minimally implemented. The primary reason for this is that DEA simply lacks the expertise to develop these types of cases.

In early 1976, DEA established a financial intelligence project unit within DEA's Office of Intelligence to develop and encourage the use of financial investigations. Specifically, the unit was estabished to

- --collect and develop financial intelligence,
- --perform research on domestic and foreign statutes to devise methods to attack the financial aspects of trafficking,
- --provide assistance to ongoing narcotics investigations, and
- --provide liaison with other agencies to coordinate exchanges of financial information and personnel with financial expertise.

The financial intelligence unit has been plagued with inadequate staffing and constantly changing personnel. The staff has consisted of only 2 people since the unit's formation, despite an estimated staffing need of 10. In addition, at least eight different people have filled the two staff positions since the unit was established.

DEA's investigative personnel do not have backgrounds in financial analysis, and financial analysis training programs for DEA's agents have been limited. Short briefings on financial techniques have been provided as a part of DEA's basic and other agent training courses. Also in May 1979, DEA initiated a 1-week course on financial investigations. By the end of 1979, 3 such courses were held for about 100 of DEA's more than 2,000 agents. However, this 1 week course can only provide a short introduction to an extremely complex topic.

Unlike the FBI and the IRS, which have many agents/accountants, DEA has none. According to the Department of Justice, DEA will not realize any growth in its overall position strength through fiscal year 1981. Thus, the Department said DEA would not be able to increase its staff with a significant number of financial specialists to assist in investigations. The Department agrees that financial specialists are needed and is considering several alternatives, but it said they were too premature to enumerate.

FEDERAL PROSECUTORS DO NOT USE CRIMINAL FORFEITURE STATUTES

Another inhibiting factor in obtaining forfeiture of narcotic traffickers' drug-related assets is that most Federal prosecutors are unfamiliar with or reluctant to use forfeiture provisions of Federal law. Three Federal statutes allow for the forfeiture of traffickers' drug-related assets:

--The Continuing Criminal Enterprise statute (21 U.S.C. 848), part of the 1970 Controlled Substances Act, allows for forfeiture of profits obtained by an individual from the criminal enterprise.

--The Racketeer Influenced and Corrupt Organization statute (RICO) (18 U.S.C. 1961-64), part of the Organized Crime Control Act of 1970, allows for forfeiture of profit, interest, or property acquired in violation of the RICO statute.

--Title 21 section 881 of the U.S. Code allows for civil forfeiture of vehicles, equipment, and other items used to facilitate controlled substance violations. In addition, since November 1978 this statute also provides for forfeiture of moneys or other things of value used in exchange for a controlled substance and all proceeds of that exchange.

One of the key problems identified at a September 1978 DEA conference on the use of financial intelligence in narcotics investigstions was that many U.S. attorneys had limited knowledge of or had a tendency not to use the forfeiture provisions available in the Continuing Criminal Enterprise and RICO statutues. The former chief of Justice's Narcotics and Dangerous Drug Section told us that prosecutors seem to be unaware of the enhanced penalties available under the forfeiture sections of the U.S. Code.

This is only a partial explanation, however. Federal prosecutors told us that forfeiture cases were complicated and time-consuming. Eight of the 10 U.S. attorneys who were involved in the 5 CENTAC prosecutions we reviewed told us that attempting to use the forfeiture provisions in those cases could have made them much more difficult to prosecute and may have jeopardized the conviction. Citing their overall scarcity of resources, two attorneys in charge of Major Drug Trafficker Prosecution Units expressed concern that attempting to obtain forfeiture of assets would not be an efficient use of their time. In addition, the U.S. Attorney of one of the primary districts prosecuting large scale narcotics cases explained that:

> "It takes considerably more time to develop a case when you're going to attempt to obtain forfeiture of a trafficker's assets. It might be more efficient to work on another case and get an additional trafficker in jail."

The Federal Strategy for Drug Abuse and Drug Traffic Prevention stipulates that financial investigations should be an integral part of the U.S. drug enforcement effort. The assets of convicted narcotics violators must be taken in order to effectively immobilize traffickers and deter other individuals from trafficking. To do this, Federal prosecutors must make more use of the forfeiture statutes.

ASSET FORFEITURES NOT ESTABLISHED AS GOAL IN CENTAC UNIT INVESTIGATIVE PLANS

Plans and proposals for implementing the five CENTACs reviewed did not specifically provide for seizure and forfeiture of traffickers assets. CENTACs were directed at obtaining indictments and arrests of leading figures in the trafficking organizations. For example, the CENTAC 13 proposal included such objectives as

--identify for immobilization members and primary customers of the organization,

--identify all associates of the organization, and

--determine the interrelationship between organization members and other major trafficking organizations.

Neither the proposal objectives nor the methods described to implement those objectives set forth the gathering of financial evidence as a means to realize forfeiture of the organization's assets.

In only one of the five CENTAC units we studied in detail did the proposal refer to the gathering of financial evidence. However, in this case, we were told by the U.S. attorney involved in the prosecution that this financial evidence was used to provide additional evidence to support conviction of the principal defendant. Asset forfeiture was neither intended nor attempted.

The combination of DEA's lack of expertise and the Federal prosecutor's unwillingness to use forfeiture statutes goes a long way to explain why the five CENTAC units neither geared up to nor achieved any significant forfeitures of traffickers assets.

DEA informed us that since our audit work was completed, it has required that all new CENTACs have as a primary objective the seizure and forfeiture of the trafficker's assets. Whether this will be enough to overcome the impediments to asset forfeitures in DEA and the U.S. attorney offices remains to be seen. The degree to which regionally controlled investigations are placing emphasis on asset seizures remains unknown. DEA has issued no specific instructions governing the objectives of these investigations.

MORE TAX INFORMATION COULD BE REQUESTED BY DEA

The IRS has valuable financial information that DEA can use in investigating drug traffickers. Although the disclosure provisions of the Tax Reform Act of 1976 placed strict controls over law enforcement agencies' access to certain types of IRS information, DEA, consistent with the disclosure provisions, can do more to secure helpful financial data.

Among other things, the Tax Reform Act of 1976 gave the heads of certain Federal agencies, including the Department of Justice, the means to obtain tax information needed in nontax criminal cases. Information collected by IRS, but not provided by or on behalf of the taxpayer, termed "third-party" information, can be obtained by submitting a written request to the Secretary of the Treasury specifying the taxpayer's name and address, the tax periods involved, the statutory authority under which the agency head is proceeding, and the specific reason why the tax information is needed.

Misunderstandings and delay by both DEA and IRS have caused a limited flow of tax-related information. IRS officials told us that they have taken steps to improve the flow of third party information to DEA. IRS's Tax Disclosure Office at headquarters monitors all DEA requests for information and makes sure IRS district offices provide the information to DEA. These officials said an extremely small number of requests are denied; however, DEA has made very few third party information requests.

This is borne out by Department of Justice congressional testimony in December 1979, that the number of Department of Justice requests (including those from DEA) for tax information has declined from 1,816 in 1975 to only 124 during a 6-month period of 1979.

Congressional action may eventually ease the way for law enforcement agencies to obtain tax information. Until then, however, DEA, which has the primary responsibility for drug law enforcement, must do all that it can to ensure that its agents--difficulties not withstanding--request and use tax-related information in narcotics investigations. This is especially important if DEA is to increase its efforts to cause forfeiture of traffickers drug-related assets.

CONCLUSIONS

Illegally derived profits and assets must be taken if major drug trafficking organizations are to be immobilized. The CENTAC program investigations have left drug traffickers' drug-related assets virtually untouched.

We attribute this to

--the lack of priority on the use of forfeiture statutes by Federal prosecutors,

--DEA's limited expertise to develop financial aspects of narcotics investigations,

--the lack of established investigative goals to seize traffickers' assets, and

--the limited use of tax-related information in narcotics cases.

Some actions have been taken by DEA to improve its efforts to take the profit from drug organizations. However, much more must be done before any substantial increase in forfeitures of drug organizations' assets are realized.

RECOMMENDATIONS TO THE ATTORNEY GENERAL

We believe that much more can be done to use financial analysis in narcotics investigations and to obtain forfeiture of traffickers' drug-related assets. We recommend that the Attorney General:

--direct Federal prosecutors to make greater use of statutes to obtain forfeiture of major narcotics traffickers' assets; and

--direct the Administrator of DEA to expand its program for the use of financial analysis and information in narcotic investigations. Such a program should include: a more effective financial intelligence unit, the hiring of financial analysts, expanded financial analysis training programs, and ensuring that tax-related information is requested and used where appropriate.

CHAPTER 4

SCOPE OF REVIEW

We performed our review at DEA headquarters in Washington, D.C.; DEA regional and district offices in Detroit, Los Angeles, New York and San Diego; Department of Justice, Criminal Division, Narcotics and Dangerous Drugs Section in Washington, D.C.; U.S. Attorney Offices and Administrative Offices of the U.S. Courts in the Southern District of New York, Southern and Central Districts of California, and Eastern District of Michigan. Some limited work was also performed at the headquarters offices of the IRS, U.S. Customs Service, FBI, and Immigration and Naturalization Service.

Our work included:

--analysis of DEA criminal investigative files;

--discussions with CENTAC supervisors, special agents, and other DEA officials;

--discussions with judges and U.S. attorneys;

--review of cases and probation reports at several judicial districts;

--analysis of criminal justice statistics provided by the Administrative Office of the U.S. Courts; and

--discussions with Department of Justice and other agency officials in Washington.

Data on CENTAC costs and results included primarily in chapter 2 were calculated on the basis of the results of all CENTAC units initiated between January 1976 and June 1979 (CENTACs 10-22). Similar data on CENTACs initiated prior to January 1976 was not available. Data on the financial results of CENTACs included in chapter 3 and other specific examples of CENTAC cases were determined from an in-depth analysis of 5 CENTAC investigations--CENTACs 10, 13, 14, 16, and 17.

We also drew from the experience gained in other GAO efforts, particularly:

--"Gains Made in Controlling Illegal Drugs, Yet the Drug Trade Flourishes," (GGD-80-4, Oct. 25, 1979);

--"Reducing Federal Judicial Sentencing and Prosecuting Disparities: A Systematic Approach Needed," (GGD-78-112, Mar. 19, 1979);

--"Disclosure and Summons Provision of 1976 Tax Reform Act--Privacy Gains with Unknown Law Enforcement Effects," (GGD-78-110, Mar. 12, 1979);

--"U.S. Attorneys Do Not Prosecute Many Suspected Violators of Federal Laws," (GGD-77-86, Feb. 27, 1978).

DESCRIPTION OF CENTRAL TACTICAL UNITS ESTABLISHED

CENTAC unit number	Description	Date established
1	Investigation of heroin being manufactured in Lebanon and distributed in the United States.	Nov. 1973
2	Investigation of a major heroin distribution system.	Nov. 1973
3	Investigation of the production and distribution of Southeast Asian heroin.	Jan. 1974
4	Investigation of the manufacture of amphetamines in Mexico and distribution to the United States.	Feb. 1974
5	Investigation of methamphetamine production in Canada and distribution in 25 States of the USA and 5 provinces of the Dominion of Canada.	Mar. 1974
6	Investigation of the various organizations smuggling cocaine from South America to the United States.	Mar. 1975
7	Investigation of the illicit production and distribution of phencyclidine and methamphetamines in the United States and Canada.	Apr. 1975
8	Investigation of over 100 individuals involved in a vast multikilogram heroin/cocaine importation distribution network covering major metropolitan areas of the Eastern United States and extending west to Chicago.	May 1975

9	Investigation of an organization that had been active in the distribution of heroin from Thailand to the United States since 1969.	Oct. 1975
10	The investigation of an LSD manufacturing and distribution organization of greatest significance.	Jan. 1976
11	Investigation of a nationwide heroin distribution organization consisting predominately of black violators dealing with Mexican heroin obtained directly from high-level foreign sources.	Apr. 1976
12	Investigation of a large polydrug trafficking network with significant Mexican and South American sources of supply using a variety of transshipment routes to the United States.	June 1976
13	Investigation of the Henry Watson organization which distributed throughout the United States huge quantities of heroin obtained directly from major suppliers in Mexico.	June 1976
14	Investigation of an illicit PCP manufacturing and redistribution organization estimated to be responsible for up to 50 percent of the criminal traffic in PCP in the United States.	June 1976
16	Investigation of the Valenzuela Family Organization, which operated clandestine heroin labs in the Culiacan Province of Mexico, smuggled it to the Bakersfield area of California, and then wholesaled the drugs along the entire eastern United States through five separate trafficking groups operating in New York and Puerto Rico.	Aug. 1976
17	Investigation of an organization based in Tijuana which distributed Mexican heroin from San Diego to Los Angeles, San Francisco, Chicago, and Detroit.	Aug. 1976
18	Investigation of an organization which consists of multiple sub-groups based in Colombia, South America, smuggling large quantities of Colombian cocaine mainly through a seaman/courier network on the Gran Colombiana Line to port cities on the East, Gulf, and West coasts of the United States.	May 1977

19	Investigations of the Herrera Family trafficking organization operated by Jaime Herrera and approximately 90 key members clandestinely manufacturing heroin in the regions of Durango and Guadalajara, Mexico, and distributing it throughout the United States.	Sept. 1977
20	Investigation of an organization involved in the smuggling and distribution of large quantities of marijuana and cocaine.	Nov. 1978
21	Investigation of a multinational cocaine trafficking organization that utilizes the most advanced and intricate techniques to protect its operations and resources.	May 1979
22	Investigation of an organization consisting of international marijuana and cocaine traffickers based in various States.	Apr. 1979

Mr. JONES. CENTAC is DEA's premiere effort to develop conspiracy investigations of high-level narcotics traffickers. Yet five CENTAC investigations we reviewed in detail, for example, obtained no asset forfeitures even though the organizations involved had estimated annual total earnings of $10 to $35 million each.

The Federal Government has to make more effective use of existing forfeiture authority in order to successfully immobilize narcotics traffickers. To accomplish this, DEA must establish forfeiture as an operational goal and develop the financial investigative expertise necessary to make such cases.

Federal prosecutors now lack experience in using the forfeiture statutes and consider their use time-consuming. However, if DEA develops the financial expertise and generates more forfeiture cases, Federal prosecutors must be willing to prosecute narcotics traffickers under these statutes.

IRS ADMINISTRATIVE REFORMS NEEDED

Second, I would like to discuss administrative actions IRS can take to speed up disclosures it makes in response to court orders and written head of agency requests, as well as the procedures it follows in disclosing information it uncovers concerning nontax crimes.

Under present law, certain Federal agency heads can gain access to information IRS has collected from taxpayers, their records, or their representatives, by obtaining an ex parte Federal district court order.

Similarly, certain Federal agency heads can gain access to information IRS has obtained from third parties by submitting a written request to the Secretary of the Treasury specifying the taxpayer's name and address, the tax periods involved, the statutory authority under which the agency head is proceeding, and the specific reason for needing the tax information.

IRS ADMINISTRATIVE REFORMS RECOMMENDED BY GAO

As depicted in charts I and II, which my colleagues will now explain in detail, in just a second, IRS district offices could respond faster to disclosure court orders and written requests if they did not have to wait for approval from IRS' national office.

We recommend that IRS decentralize the authority to disclose information under existing law. However, IRS national headquarters should make the final determination when a district director believes that compliance with a court order or written request might endanger a confidential informant or impair a tax investigation.

Mr. Chairman, I would like Mr. Gunner to go up to the charts and Mr. Harris will walk us through these and explain them.

Mr. HARRIS. Mr. Chairman and committee members, as you can see in chart I, under present procedures, a Federal agency head forwards court orders and written requests for tax information to the Director of IRS' Disclosure Operations Division here in Washington. Upon receipt, each request is assigned for processing to an operations analyst. He or she will send a clearance request to the affected IRS district office, and there are 58 of those around the country. The district disclosure officer, who is responsible for processing the clearance request, initiates the gathering of the information and routes the request to the District Office's Examination, Collection, and Criminal Investigation Division personnel for review.

Once the clearance information is received from the three divisions, the district disclosure officer forwards it to the operations analyst in Washington, who prepares a draft authorization or declination letter.

The section chief, branch chief, and division director will review the letters sequentially, with the division director making the final decision. If the division director authorizes disclosure, an authorization letter is forwarded to the district disclosure officer who is then free to disclose the requested information, assuming the district can locate that information.

As you can see in chart II, under a decentralized system, the Federal agency heads would forward court orders and written requests for tax information——

Senator CHILES. Chart No. 2 is the way you say it could be simplified?

Mr. GUNNER. Could be decentralized.

Mr. HARRIS. This information would be forwarded directly to the appropriate IRS district office. Once the district disclosure officer obtains clearance from the District Office's Examination, Collection, and Criminal Investigation Division personnel, the district director then, in consultation with the disclosure officer, could authorize disclosure, where appropriate.

If the disclosure is authorized, the information, if and when collected, could be disclosed immediately. However, of course, as Mr. Jones said, we recommend the national headquarters make the final determination when a district director believes compliance with a court order or disclosure request might endanger a confidential informant or impair a tax investigation.

Senator CHILES. That would be in a few instances. Most of the cases the disclosure could be made right there by the district director.

Mr. HARRIS. Yes, sir.

Mr. GUNNER. There have been very few, if any, instances where IRS found they could not disclose the information requested.

PROCESS TIME SAVED BY GAO RECOMMENDATIONS

Senator CHILES. Do you have any kind of timeframe of the time it is taking, any kind of average times, parameter times of the way the request is going now and how that could be shortened by the procedure you set forth?

Mr. GUNNER. Both court orders and written requests on the average in the four districts we looked at—Jacksonville, Manhattan, Los Angeles, and Philadelphia—are averaging 2 to 3 months between the time the request is first received at IRS and the time IRS actually provides the information to the requesting agency.

We have no real means to estimate exactly how much time this would save. IRS estimates about 20 days on average would be saved. We have no reason to disagree with that figure. In some cases it could be a lot faster. In other cases, we are still going to encounter the problems they run into now, such as locating information in the service center, trying to get it out of the Federal Records Center. Changing the law or any administrative process would not affect those problems.

Senator CHILES. You are talking about a shortening of the time by about a third then, approximately a third?

Mr. GUNNER. I think that would be a good figure to go by.

It still is not going to resolve the whole problem. It would help.

DISCLOSURE OF NONTAX CRIME INFORMATION FROM THIRD PARTIES

Mr. JONES. Next, Mr. Chairman, I would like to discuss IRS' centralized process for disclsoing information of nontax crime that it obtains from third parties.

As depicted through charts III and IV, which my colleagues will also explain in detail, IRS could also speed up processing of its employees' proposals to disclose such information. Again, this could be done by decentralizing the authority to make such disclosures. Decentralization should also encourage employees to seek permission to disclose more third party information to appropriate law enforcement agencies.

Mr. HARRIS. Mr. Chairman, under the current system, as depicted in chart III, an IRS employee who discovers an indication of a nontax crime in the course of day-to-day business would forward that information through appropriate channels to IRS' Disclosure Operations Division in Washington.

Senator CHILES. So we understand this clearly now, this is where an agent in the process of looking up tax matters finds a nontax—indications of a nontax crime.

Mr. HARRIS. That is correct.

Senator CHILES. In his investigation.

Mr. GUNNER. Mr. Chairman, I would like to point out this refers only to a situation where IRS gets the information from a third party.

Senator CHILES. This is not in the examination. This is where they get it from, a third party.

Mr. GUNNER. That is correct. The only authorization for disclosure in this regard is in the law now.

Senator CHILES. So it could be a drug-related crime, for example?

Mr. HARRIS. That is right. Currently the law, of course, would not allow IRS to forward information that it gets directly from a tax return. If it comes from a third party, this procedure would apply.

Senator CHILES. So right now under the law, if it actually was while they were investigating a tax return itself, and a crime was disclosed to them, they cannot notify a law enforcement agency and tell them of that.

Mr. HARRIS. That is correct.

Senator CHILES. But this is where it comes from, a third party?

Mr. HARRIS. Yes, sir. If, for example, someone calls in and makes an allegation, that information could be provided through these channels.

Mr. JONES. Mr. Chairman, another example, perhaps equally relevant, would be indications of substantial cash deposits and withdrawals over a period of time, which would be on record at a bank, or savings and loan showing that Arnold Jones had lots of cash he wanted to hide.

Mr. GUNNER. One more example, I have seen tax returns of alleged narcotics traffickers where they have reported huge sums of money. That information would not be disclosed by IRS under the present law.

Senator CHILES. All right.

Senator SCHMITT. Excuse me, but if the IRS agent had knowledge of bank records that shows the same information, that would be disclosed?

Mr. GUNNER. If he got the bank records from the taxpayer himself, it would not be disclosed. However, for example, if an informant had told the agent about where that money came from, or just that much money is being moved around, that could be disclosed.

Senator SCHMITT. Or the existence of the bank records through an informant.

Mr. GUNNER. Yes, that would be disclosed.

Senator CHILES. OK, go ahead.

CLEARANCE PROCESS

Mr. HARRIS. Once the employee forwards the information through channels to the Disclosure Operations Division, an operations analyst who receives the information will determine whether it can be disclosed. Then the section chief, branch chief, and division director will review the analyst's decisions sequentially with the division director to make the final determination as to whether the information can legally be disclosed.

If the disclosure division director determines that the information was obtained from a third party, it can be forwarded to the appropriate Federal agency head. Otherwise if, for example, it is from a tax return, it would have to be retained in IRS files.

Senator SCHMITT. Is there any estimate on the time this process takes?

Mr. GUNNER. On average, this is taking 43 days through the current process. We will be pointing out that the major benefit in this decentralization probably will not be in terms of timeliness. Rather, we noted that an IRS employee in the field who has to forward this information through the entire process has trouble getting feedback as to what happens to the information.

That is not a very good feedback system in terms of encouraging people to come forward when they spot this type of crime.

Senator SCHMITT. That would indicate they just wouldn't want to be bothered doing it.

Mr. GUNNER. I would like to point out that is not the fact of the matter in examining what IRS has done. Of those that have come forward, IRS has disclosed every one, to our satisfaction, that could be disclosed and didn't fall into the category of pure taxpayer return information. That fact alone, however, does not impact back at the field level.

PROCESS SIMPLIFICATION RECOMMENDED BY GAO

Senator SCHMITT. How would you simplify that, then?

Mr. GUNNER. Simply by not having the employee, if he spots the information about the nontax crime—forward the information to IRS headquarters. We propose he be able to go directly to his disclosure officer and in consultation with the district director, the highest ranking IRS official in the State, they make the decision. They have the expertise and legal counsel available to them. We feel they can make the determination and the information can be disclosed within a matter of a day or two if it is disclosable.

By doing that, word would get around to the employees——

Senator SCHMITT. That agent is going to know he is able to pass that information on. He has a part to do in passing it on, really, because he goes and gets permission and then he passes it on.

Mr. GUNNER. He is going to see the action taking place and that will get around to other employees in the field.

Senator CHILES. Sometimes a difference to 2 or 3 days and a difference of 40 days could be crucial in an investigation, I would think, as to whether another law enforcement agency gets that information. It could be very necessary.

Mr. GUNNER. Undoubtedly. In individual cases, it probably could be crucial.

Mr. JONES. Mr. Chairman, the Congress might want to consider relieving individual employees of the financial responsibility that now would be a consequence of current law and proposals for that, of course, are in Senate bills 2404 and 2405. That would sort of, it seems to me, be an emphasis on getting more involvement on the part of IRS field people.

JOINT DEA/IRS INVESTIGATIONS

The third administrative action I would like to discuss relates to joint DEA/IRS investigative efforts against narcotics traffickers.

In accordance with a 1976 DEA/IRS agreement, DEA provides IRS with names and background information on high-level narcotics traffickers referred to as DEA class I violators. Although IRS gives high priority to evaluating those leads for their criminal and civil tax potential, that process has produced few tangible results.

Criminal tax cases are complex in nature and therefore usually take several years to investigate and prosecute. By the time IRS develops a tax case on a class I violator, the violator often has been incarcerated for narcotics-related or other offenses. In such instances, the Justice Department generally will not prosecute the tax charges because of its dual prosecution policy, which I will discuss shortly.

To be effective, IRS needs to learn the identities of DEA targets as early as possible. The February 1980 revision to the DEA/IRS agreement does not address this problem.

JUSTICE'S DUAL PROSECUTION POLICY

The fourth area in which administrative action is needed is the Justice Department's dual prosecution policy. That policy provides that all offenses arising out of a single transaction, such as narcotics trafficking and evading taxes on the ensuing profits, should be tried together.

Since narcotics violators often are arrested and convicted on a drug charge before IRS can fully develop the related tax case for prosecution, IRS would have wasted scarce investigative resources in those instances where Justice declines the tax case.

As an alternative strategy to remedy this problem, Justice needs to develop a more flexible dual prosecution policy. Presently, Justice gives special consideration only to class I violators who receive prison sentences of less than 5 years on nontax charges. However, in a case where Justice and DEA have not pursued asset forfeiture under the controlled substance laws and the trafficker's illicitly derived assets remain intact, flexibility to consider a subsequent prosecution for a tax violation might be desirable.

GRAND JURY INVESTIGATIONS

The fifth administrative action I would like to discuss relates to IRS' involvement in grand jury investigations, a powerful investigative body which, from IRS' standpoint, can be particularly valuable in the narcotics area.

Since passage of the Tax Reform Act of 1976, the grand jury has been used increasingly by IRS and other law enforcement agencies as a tool for joint investigation and prosecution because it has several advantages over the normal administrative process.

A special agent assigned to a grand jury investigation seldom has to deal with disclosure, summons, or dual prosecution problems. However, it takes a long time for IRS to approve an agent's participation in a grand jury.

GRAND JURY PROCEDURES NEED TO BE STREAMLINED

As depicted in chart V, which my colleagues will now explain, IRS' current procedures for approving participation in grand jury investigations are cumbersome and time consuming.

We would like to walk you through that process again, Mr. Chairman.

Senator CHILES. All right, sir.

Mr. HARRIS. The current process begins at the district level with receipt and evaluation of a Government attorney's grand jury request by an IRS special agent. The attorney's request is forwarded through the director of the District Criminal Investigation Division, the district director and regional commissioner to the appropriate regional counsel for approval. If approved by the regional counsel, the request goes directly to the Justice Department's Tax Division for review. With Tax Division approval, a U.S. attorney or strike force attorney can initiate an investigation or integrate IRS agents into a grand jury investigation, which is already in process.

I should mention that IRS is presently considering a revision to the grand jury review and approval process. The revision would delete the regional commissioner's review and substitute the district counsel review for the existing regional counsel review.

Senator CHILES. How much time do you estimate is now taken in this present process?

Mr. GUNNER. We did some limited sampling in the Manhattan and Philadelphia districts. Manhattan was averaging 131 days in total.

Senator CHILES. 131 days?

Mr. GUNNER. Yes; but there are some significant aberrations from that. I believe there were a couple cases pointed out during the permanent subcommittee hearings last year that took well over a year.

In fact, that does happen. The problem in this review system is that every one of these individuals along the line has to convince himself or herself that this grand jury request is appropriate, that the administrative process is not better, and that there is a high potential tax case involved here.

To some extent, that is understandable. You want to have good control over a powerful body like the grand jury and your participation in it. In other words, a situation like this takes a long time and actually defeats the purpose of getting an IRS agent involved in the grand jury.

Senator CHILES. What is your recommendation, then?

Mr. GUNNER. We didn't need to come up with a recommendation because IRS recognizes the problem themselves. They are in the process of considering a revision to this entire approval process which basically would cut out the regional commissioner review. That will, however, only cut out 2 weeks of the process on average. By the time other IRS officials have looked over grand jury requests, they are usually pretty clean.

The big stumbling block seems to be the regional counsel. The attorneys get involved because they have to do the legal analysis. The problem is partially due to staffing and centralization. There are only usually one or two people at each of the seven regions throughout the country responsible in the regional counsel's office for approving these requests. They also have other duties, too.

Senator CHILES. The IRS plan does not envision cutting out the regional counsel?

Mr. GUNNER. The IRS plan would substitute district counsel review for the regional review. At an absolute minimum, that would insure that each grand jury request, I think, would get a pretty quick look. Sometimes now a regional counsel just doesn't have the time. He might be looking at one when another comes in for review.

Senator CHILES. Do you think that will make a substantial difference in the time?

Mr. GUNNER. There is another aspect to that. Regional counsel attorneys have the expertise. District counsel attorneys have not been doing this and do not have the expertise. It will take some time to have a significant improvement in the timeliness, but I think it is the way they probably need to go in order to get there eventually. Again, I would like to point out that is IRS' proposal, not GAO's.

Senator CHILES. Does GAO have any recommendation how else it can be done?

Mr. GUNNER. We would like to see how the new proposal works out first.

Mr. JONES. I might add, as the chair and the committee knows, this is addressed in the bill. I believe it is S. 2402, which has a provision encouraging the participation of IRS in joint tax and nontax investigations which, if enacted, of course, obviates the necessity of going through the title XXVI grand jury process.

GAO VIEW OF S. 2402 GRAND JURY PROVISIONS

Senator NUNN. What is your view on that provision?

Mr. JONES. I think it is quite clear that that provision of law would get to the point of accelerating IRS involvement in the grand jury process.

To the extent the grand jury process is not as effective as it should be because of the cumbersomeness of the approval process as it stands now, that would be a positive step.

I think that is what that section addresses. It would render moot the need to go through the large series of reviews in IRS. It obviously expresses the sentiment of the Congress that IRS should be more involved in these cooperative efforts.

The last administrative action I would like to discuss relates to IRS using its jeopardy and termination assessment powers more effectively.

As we discussed in detail in our December 1979 testimony, between 1972 and 1974 IRS systematically used jeopardy and termination assessments against individuals suspected of, or arrested for, a drug law violation as part of its narcotics traffickers program. In May 1974, however, due to various alleged abuses of its assessment powers, IRS modified its criteria for using jeopardy and termination assessments against narcotics traffickers to assure that they were used only in cases with substantial and documentable tax violations. Then, in 1976, Congress amended the law to afford taxpayers subjected to such assessments quicker judicial remedy than had previously been available.

Also, in January 1977, the Supreme Court ruled that a valid search warrant was needed to seize a taxpayer's possessions on the taxpayer's private premises.

There was definite evidence that IRS had abused its assessment powers during the early and mid-1970's. However, statistics relating to IRS' use of its assessment powers in the last 5 years indicate that IRS may have abandoned use of those powers even in situations where it could legitimately and effectively use them.

We believe that IRS can make more effective use of its assessment powers and should increase their use under proper circumstances, subject to the appropriate legal and administrative safeguards.

Mr. Chairman, this concludes my abbreviated testimony. We would be very happy to respond to any questions.

Senator CHILES. Thank you very much, Mr. Jones, for your full statement and your abbreviated statement. I think it is very comprehensive. We appreciate the time with which you all have made this report available to us.

IRS LACKS NATIONAL STRATEGY

Mr. Staats, in his December testimony, indicated one of the major factors inhibiting IRS' ability to effectively combat drug trafficking is that IRS did not have a well-defined national strategy for its criminal investigative activities.

Does GAO still conclude that IRS' lack of a national strategy for criminal investigations is a major impediment to IRS playing a more effective role in combating drug trafficking?

Mr. JONES. Mr. Harris oversaw that investigation. I am going to let him provide you the answer.

Mr. HARRIS. Yes, sir, we are still of that opinion. In our report last November, our main conclusion was that IRS lacked a long-range national strategy in the criminal enforcement area. We still believe that although IRS is taking action to change both its short- and long-range planning systems.

Senator CHILES. Is there any law or any other obstacle that you have been made aware of that would prevent IRS from developing a national strategy for criminal investigations?

Mr. HARRIS. No, sir, it is purely a matter of administrative policy.

Senator SCHMITT. Would the chairman yield? Should the IRS and the Treasury Department be developing that strategy or should it be part of a strategy developed by the Justice Department?

Mr. HARRIS. I believe, as we said in the report, IRS is the key in developing the strategy. One of our key recommendations, however, was that it needed to coordinate with the Attorney General and the Justice Department, both at the national and local levels. Justice has to have input because it does IRS no good to investigate cases if the U.S. attorney is not going to prosecute. So it is a matter of Federal coordination.

Senator SCHMITT. So they are a key part of the implementation of the strategy, but really without the Justice Department providing the overall framework and willingness to move on that strategy in the final analysis——

Mr. HARRIS. Absolutely, sir. It is a two-way street.

Senator SCHMITT. I am trying to decide who is the chicken and who is the egg here.

Senator CHILES. I think you are also talking about the mama chicken maybe and we are talking about the other chickens.

Senator SCHMITT. Maybe the Justice Department is the rooster.

Senator CHILES. Senator Nunn and his Subcommittee on Permanent Investigations and some of us have been talking for a long time about the need for this national strategy. Within the need for the national strategy, certainly there is a need for IRS strategy as to how they are going to handle criminal investigations. So we are talking about both, I think.

IRS ALLOCATES TOO FEW RESOURCES TO DRUG INVESTIGATIONS

According to the IRS Subterranean Report, about 70 percent of the unreported income is from illegal sources as a result of drug trafficking activities.

In view of that fact, do you feel that it is appropriate for IRS to only devote 6 percent of its criminal investigative resources to investigating drug traffickers?

Mr. JONES. Mr. Chairman, I will preface a more detailed answer my colleagues may give by saying that in the best of all possible worlds, with the authority that is on the book, the Justice Department, including the DEA, would investigate, arrest, bring to trial, and seize all the assets of those persons involved in illegal trafficking. Therefore, since there would be no assets from which one could seize taxes, you might have a very benign IRS involvement. That is in the very best of all possible worlds we dream about. That will not happen. There is a need, very much, for the Internal Revenue Service to be involved. With that preface, I would like one of my colleagues to provide an answer.

Mr. HARRIS. On the surface, sir, it would seem like the resource IRS is devoting are not quite enough, particularly since I believe Mr. Kurtz himself has said IRS' figures for unreported income from illegal activities are probably understated.

Senator CHILES. That is right. If they only took certain facts—I think in our hearings they said they felt it was probably a very low figure.

Mr. HARRIS. That is right. I think we have to keep in mind that IRS has other responsibilities in the criminal enforcement area, too. In developing their criminal enforcement strategy, they have got to take all of these things into consideration.

On the illegal unreported income side, I don't believe there is any question that the drug problem versus, let's say, unreported income from gambling, prostitution, and other activities is much higher. Therefore, the narcotics area should probably get much more emphasis.

Senator CHILES. We are happy to have participating with us this morning Senator Nunn, who is chairman of the Permanent Subcommittee on Investigations who has been vitally interested in this subject and is the prime introducer of the bills that we referred to this morning in which we are trying to move IRS back into the picture of combating drug trafficking.

Senator Nunn, we are delighted to have you with us this morning. If you have any questions, we will be delighted to have you participate.

Senator NUNN. Thank you very much.

I might add, in addition to your interest as chairman of this subcommittee, your outstanding involvement on a continuing basis in the PSI Subcommittee has been invaluable in our deliberations. You also are a major cosponsor of the bills in question.

Just a couple of questions. Mr. Jones, according to the Internal Revenue Service Subterranean Economic Report, almost 70 percent of the unreported income from illegal sources is the result of drug trafficking activities.

In view of this fact, do you feel it is appropriate for the Internal Revenue Service to only devote 6 percent of its criminal investigative resources to investigating suspected drug trafficking? As I understand it, there are 2,800 total IRS criminal investigators out of 8,000 employees. Of that 2,800, 6 percent investigate drug traffickers, meaning 94 percent are occupied elsewhere. Is that an appropriate allocation of resources considering the magnitude of the drug problem?

Mr. GUNNER. Mr. Nunn, I would like to provide an answer to your question. We feel that if IRS were to develop a well-founded strategy for its criminal enforcement activities, based on good statistics about what the real problems in the criminal tax area are that as a result of that analysis, the strategy would call for application of more resources in the narcotics area.

The exact amount of that would have to await analysis by IRS.

Senator NUNN. In other words, you think there certainly is room for more effort in the narcotics area by IRS, and you think the allocation of resources now is not in proportion to the magnitude of the narcotics problem.

Mr. GUNNER. Yes, sir.

Senator NUNN. But the exact amount of the increase is something that would require further analysis?

Mr. GUNNER. Yes, sir. In fact, IRS is developing an approach to long-term planning which hopefully will yield the numbers they need to determine the resources to apply to that problem.

TERMINATION/JEOPARDY ASSESSMENTS USE TOO LITTLE BY IRS

Senator NUNN. The Internal Revenue Code provides that when IRS determines the collection of a tax may be in jeopardy, it may immediately assess and collect the tax through seizure of property, if necessary.

If the date for filing a return to pay income taxes has not passed, a termination assessment may be made of the tax liability and the property may be seized before the end of the tax year.

In July of 1971, IRS established a program which made systematic tax investigations of middle- and upper-echelon narcotics dealers. Mr. Staats presented testimony at the PSI hearings which showed IRS all but abandoned the use of jeopardy and terminations assessment. Is there anything in the law that prohibits IRS from using these powerful tools when appropriate against the drug traffickers?

Mr. JONES. The answer to the last question is no, there is nothing in the law that precludes the use of these tools. It is the case that there were allegations and I am sure more than just allegations of abuses back in the early- to mid-1970's of this tool.

We have some statistics in the full testimony, Senator Nunn, which indicates a significant dropoff in the use of jeopardy assessments and tax terminations.

What we are sort of saying now is perhaps, and I can't judge whether justifiable or not, there was a significant reduction in the use of these tools. You are now saying, "IRS, you might want to consider in a different climate, the use of these tools now." Narcotics trafficking, as we all know, is still out there.

Senator NUNN. I think it is particularly appropriate in class I and II categories. I understand the abuse took place when there was so much Federal enforcement directed at street trafficking, where they find somebody with very small amounts of drugs and make an assessment against them on that basis. That is not what we are advocating.

It seems the Internal Revenue Service cannot get the pendulum in the middle. They either go to the far extreme one way or the far extreme the other. Now we are, I suppose, on the left-hand swing of that pendulum, which is taken to the point of absurdity. No one is advocating you go back and make street arrests and jeopardy assessments based on small amounts. But for major traffickers, certainly this is a very, very powerful tool, is that not correct?

Mr. JONES. You are absolutely correct.

IRS INVOLVEMENT IN CENTAC PROGRAM INVESTIGATIONS

Senator CHILES. Do you know whether IRS agents were involved in any of the CENTAC program investigations? You talked about five cases that you reviewed. I know that is a DEA program, and they were using that to go after the major offenders. You pointed out that the estimated annual earnings were $10 to $30 million each in the five cases you reviewed. There was no forfeiture at all, no seizure at all. Was there any IRS involvement in any of those cases?

Mr. JONES. In the CENTAC program, as well as local involvement, Customs Service involvement, we do not know—my colleagues may know specifically whether or not IRS was involved in the five cited cases. Were they?

Mr. HARRIS. We don't know that, sir. I can try to get that information and submit it for the record.

Senator CHILES. I think it will be worth knowing because I would like to try to find out some way why either DEA or IRS, why somebody didn't seize something out of those five cases, when the average was $10 to $35 million per ring.

Mr. HARRIS. In some of these cases, under the CENTAC program, IRS officials, as well as Customs, and sometimes local officials, are involved. Whether or not IRS officials were involved in the specific cases we cited, I don't know. We will follow that up and provide it for the record.

CATCH-22 SITUATION CREATED BY THE TAX REFORM ACT OF 1976

Senator NUNN. We have run into an interesting catch-22. Mr. Kurtz testified before our subcommittee that there were 21 major narcotics cases brought by the Internal Revenue Service in, I believe, calendar year 1979, according to my recollection. We asked for detailed information on that, and Mr. Kurtz finally came back after a great number of contacts and said that information could not be made available because of the disclosure provision in the Tax Reform Act of 1976. So the Justice Department does not know about these cases, can't find any record of them, and the Internal Revenue Service knows, but they can't tell. We are in an absurd situation where the Federal Government—namely, the Congress—cannot even find out what it is the Internal Revenue Service is doing in terms of class I prosecutions. So what we have got is such a great degree of privacy under the Tax Reform Act, according to IRS' interpretation, that the Congress cannot find out what IRS is doing. And in an effort to protect the taxpayers, what we have done is to create an agency down there that cannot be held accountable by the Congress.

It is an absolute absurdity. If it wasn't so serious, it would be laughable. We can't even find out if the 21 cases that they have made would be agreed to by Justice Department as to whether they were serious violations.

Has the General Accounting Office run into any of those catch-22 situations in your investigation in terms of things you cannot get because of the Tax Reform Act as interpreted by IRS?

Mr. GUNNER. Mr. Nunn, fortunately there is a provision in the Tax Reform Act which authorizes GAO access to tax information for the purpose of doing the analyses that we have to do.

Senator NUNN. So you have been able to get that?

Mr. GUNNER. Yes, sir.

Senator NUNN. But you can't tell us, right?

Mr. GUNNER. That is correct, sir. We are subject to the same penalties that IRS employees are subject to.

Senator CHILES. We took care of GAO. We should have taken care of ourselves.

Senator NUNN. The Congress can't find out. At least the General Accounting Office knows. Can you wink if everything is going all right, something like that, or is that a felony?

MISUSE OF INFORMATION BY JUSTICE

Senator CHILES. Are you aware of any incidences, either before or after passage of the Tax Reform Act of 1976, in which officials from the Department of Justice have misused information obtained from IRS?

Mr. GUNNER. No, sir.

Senator CHILES. Has that come to your attention?

Mr. HARRIS. No, sir.

Mr. GUNNER. No, sir.

SELECTED TAX ACT EXEMPTIONS FOR IRS

Senator CHILES. Each of us is obligated to notify the police if we discover the evidence of a crime. Withholding that information is a felony itself, if the crime would amount to be a felony. And yet we find we provided a provision where IRS does not have to do that. We make it a crime for IRS agents to carry out that basic duty that each of us have as citizens. Do you believe it would be desirable to totally exempt the IRS from disclosure provisions of the Tax Reform Act of 1976 as it relates to investigation of class I criminals?

Mr. JONES. Mr. Chairman, because I like to come prepared, I have our legal assistant here who has read in some detail that provision of the bill. With your permission, I would like to have him address that question.

This is Ken Meade.

Mr. MEADE. Mr. Chairman, I think we alluded in our testimony to a need to give IRS some mechanism to disclose information that it comes across on its own and where the Justice Department and the other agencies have no prior knowledge of the information.

Under present law, IRS cannot go to court and ask the judge for permission to disclose the information to the appropriate enforcement agencies. That does place the Justice Department in a difficult position because those who do have the ex parte order authority do not have the basis or the necessary information for the ex parte order.

One of our recommendations is in the process of amending the Tax Reform Act, that you include some mechanism for IRS to initiate disclosure of taxpayer return information.

Of course, right now for so-called third-party information IRS can unilaterally initiate disclosure, but they cannot for taxpayer return information.

Mr. JONES. I just wanted to add, Mr. Chairman, there is a provision in one of the four bills introduced requiring an affirmative action posture on the part of the Internal Revenue Service to disclose evidences of nontax crime. That certainly addresses the issue that you just asked about and addresses it in a very positive way.

I might also add, Mr. Chairman, since there are a series of questions we are being asked concerning the bill, I would like to offer, as we often do, that the General Accounting Office provide an analysis of these bills.

Senator CHILES. We would like to have that.

Senator NUNN. I might suggest that it be also submitted to the Baucus Subcommittee of the Finance Committee, where this legislation is pending. I think that would be helpful to them. Hopefully Senator Baucus is going to have hearings on it in the very near future.

Senator CHILES. I think we would like to have that. I think we may want to talk with your counsel and determine whether there is any possibility of getting some language in this one particular area. I am concerned that it may take us a year to pass the bill. We may want to try to say something in the appropriations bill.

It seems to me unconscionable that you will have a law enforcement agency, as we have the IRS, perhaps able to come across any kind of crimes and the example everyone always uses, a plot to assassinate the President or some other high Government official, and it would be a crime for them to disclose that information. That just seems to be unconscionable if we put ourselves into our kind of dilemma.

Mr. JONES. I agree, Mr. Chairman.

Senator NUNN. Mr. Chairman, are you hinting we might put legislation on the appropriations bill?

Senator CHILES. No, sir, we would never do that. We might put a prohibition against spending any money unless you could tell people a crime was going on.

Senator SCHMITT. We are very sneaky on this committee.

Mr. Chairman, one final question.

IRS/CUSTOMS COORDINATION

Do you know of any specific coordination structure that exists between the IRS and the Customs Service?

Mr. JONES. Mr. Chairman, I don't know of any, and maybe one of the gentlemen here can answer the question. Does your question concern difficulties in interfacing——

Senator SCHMITT. Does anything exist other than in a case-by-case situation—is there any regular periodic or official situation set up between IRS and the Customs Service? They do happen to be in the same department.

Mr. GUNNER. The liaison officer within the IRS Criminal Investigation Division has responsibility for both the Customs Service and numerous other agencies and does, in fact, have some type of coordination meetings—how often, I don't know.

Senator SCHMITT. During your investigation, have you run across any example of where the IRS has helped to target Customs activity relative to the interdiction of drug trafficking?

Mr. GUNNER. No, sir.

Mr. JONES. Senator Schmitt, a partial answer to your question would involve some provisions of the Bank Secrecy Act, which requires these currency transaction reports. I do believe the Secretary of Treasury is held under law as being responsible for administering those provisions. That has been delegated down to the Commissioner of Customs. To that extent, they are responsible for administering this provision of law, they would then provide indications of currency transactions, let's say, exceeding $10,000 in that case, or people going out of the country and coming in with cash in excess of $5,000 to the appropriate law enforcement agency. That would entail interacting with the Internal Revenue Service. That is the only thing I can think of.

Senator SCHMITT. That would be the Custom Service informing IRS.

Mr. JONES. Yes, sir.

Senator SCHMITT. As far as any information IRS might gather through third parties, that would relate to potential drug traffic that the Customs Service should have knowledge of for interdiction purposes, you know of no example of where that has occurred or no mechanism under which it would occur.

Mr. HARRIS. If IRS obtains information from a third party, the mechanism would be the one we discussed earlier.

Senator SCHMITT. I understand that, but I am asking specifically, do you know of any circumstance of where that mechanism has been utilized to inform the Customs Service or provide the Customs Service with information that it could use in its drug interdiction efforts?

Mr. HARRIS. Not specifically, no, sir. I am not familiar with any specific cases where that has been done.

Senator SCHMITT. Do you know of any impediments in law that would prevent coordination between the Customs Service and the IRS?

Mr. HARRIS. No, sir.

Senator SCHMITT. Other than what has been referred to in general terms?

Mr. HARRIS. No, sir. Again, that would be an administrative policy matter. There is nothing in the law which prevents two agencies from coordinating. In IRS' case, however, there are some problems when coordination involves the disclosure of certain kinds of information.

DEFINITION OF TAXPAYER RETURN INFORMATION

Mr. MEADE. I might supplement his response to your question. As the Tax Reform Act amendments are being considered, some consideration should be given to clarifying what taxpayer return information is. Information that the taxpayer himself provides and is provided by someone on his behalf cannot be disclosed administratively by IRS. There is some confusion as to exactly what provided on his behalf means.

Senator SCHMITT. Do you think that should be part of the clarification we undertake in present law?

Mr. MEADE. Yes.

Senator SCHMITT. Will that discussion be included in the report you just volunteered to make?

Mr. JONES. Yes, we will give you a full and detailed GAO comment on the proposed legislation.

Senator SCHMITT. But also on those things that you think might further assist in this kind of a problem such as was just mentioned.

Mr. JONES. Most definitely, yes, sir.

Senator CHILES. We thank you very much for your testimony and your report.

DEPARTMENT OF JUSTICE

STATEMENT OF M. CARR FERGUSON, ASSISTANT ATTORNEY GENERAL, TAX DIVISION, DEPARTMENT OF JUSTICE

ACCOMPANIED BY:

PHILIP HEYMANN, ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION
JERRY FEFFER, TAX DIVISION

Senator CHILES. Next the committee will receive testimony from M. Carr Ferguson, Assistant Attorney General for the Tax Division, Department of Justice.

The Department of Justice is the major customer for IRS information as it relates to prosecution of drug traffickers and other criminals. Therefore, in order for the committee to get a complete picture of administrative reforms that are both needed and possible within the current scope of the law, we have provided Justice to provide the committee with testimony.

PREPARED STATEMENT

You can proceed with your testimony. We will put your statement in full in the record and you can brief that for us.

[The statement follows:]

STATEMENT OF M. CARR FERGUSON

Mr. Chairman, I appreciate this opportunity to appear today to discuss efforts to improve coordination between the Internal Revenue Service and the Department of Justice in the investigation and prosecution of non-tax federal criminal cases. Here with me is Assistant Attorney General Philip B. Heymann of the Criminal Division. At the conclusion of my prepared remarks, we will be happy to answer any questions you may have.

The Department of Justice is committed to effective law enforcement and to developing and maintaining the most cooperative and efficient possible working relationship with the IRS. Mr. Chairman, we deeply appreciate that you share our concern over the impediments to cooperative law enforcement created by the restrictive disclosure provisions of the Tax Reform Act of 1976. Thanks to the efforts of you and your colleagues, we are now pleased that this important issue will be the subject of thorough review by the Congress.

The nature and extent of the law enforcement problems created by the Tax Reform Act of 1976 were the subjects of comprehensive testimony by the Department of Justice before the Permanent Subcommittee on Investigations last December. I do not wish to reiterate that testimony today, rather to review our recent efforts, in cooperation with the IRS, to improve existing administrative procedures under the Act.

As you know, tax information is often essential to successful investigation and prosecution of many serious federal crimes, particularly organized crime and narcotics trafficking. However, Section 6103 of the Internal Revenue Code, enacted by the Tax Reform Act of 1976, severely restricts this Department's access to this essential information in non-tax cases. Section 6103(i)(1) permits disclosure of returns and 'taxpayer return information" only pursuant to a court order obtained by a law enforcement agency. Section 6103(i)(2) permits disclosure of "return information other than taxpayer return information" only upon written request of a federal agency head or other designated official. Section 6103(i)(3) allows the IRS to disclose to other federal agencies, on its own initiative, "return information other than taxpayer return information" only where such information "may constitute evidence" of a crime and only "to the extent necessary to apprise" such other agency of the crime.

The Tax Reform Act reflects laudable Congressional concern for the protection of the individual's privacy. However, we believe that amendments to the Act's disclosure restrictions will be necessary to achieve a more appropriate balance between legitimate individual privacy interest in tax information and legitimate law enforcement needs for that information. In the last several months, the Administration has been actively involved in developing such amendments. However, there are administrative steps that can be taken right now to improve our procedures and performance under the existing law. In my remarks today, I will bring this Subcommittee up to date on our current efforts, in cooperation with the IRS, to formulate and implement needed administrative improvements.

There have been frequent meetings between representatives of the IRS and the Department since the Tax Reform Act of 1976 was enacted. In the early stages, the primary focus of these meetings was on compliance with the Act. Only recently have we begun to move beyond the basic implementation stage associated with any complex new law, as we have acquired sufficient experience under the Act to identify with some precision the specific problems that have resulted and to devise measures that will alleviate those problems. Thus, it was not until 1979 that the Department and the IRS were able to begin a detailed, informed analysis of existing administrative procedures to determine what specific improvements could and should be made to facilitate law enforcement.

At this time, I would like to outline the improvements this Department has made in its internal procedures under

Section 6103(i). In March of 1979, the Criminal Division revised its procedures for processing applications for court orders and information requests. Prior to that time, these applications were processed by the various Sections of the Criminal Division which had jurisdiction over the substantive offenses being investigated or prosecuted. For example, when a United States Attorney's Office needed tax information in an organized crime case, the application was forwarded to the Organized Crime and Racketeering Section, which processed it for Assistant Attorney General Heymann's approval. In March of 1979, this processing function was centralized in a new Office of Legal Support Services, so that all applications for tax information under Section 6103(i) are now processed by attorneys who have become disclosure specialists. The IRS also changed its procedures to accommodate this centralization. Not only does centralization expedite our internal procedures, it also insures that our papers are prepared in a uniform manner, facilitating faster review by the IRS. In addition, our disclosure attorneys deal regularly with IRS disclosure officials, with the result that each better understands the problems and needs of his counterpart. This improved understanding results in improved performance, with fewer misunderstandings and avoidable delays.

The Department is also encouraging all United States Attorneys' Offices to make more frequent and effective use of Section 6103(i) procedures. There are many cases in which tax information can properly be obtained to strengthen the Government's evidentiary showing, even though it is not absolutely essential to satisfy the burden of proof. However, the restrictive provisions and procedures of the Tax Reform Act have so discouraged federal prosecutors that many view tax information as so difficult to obtain on a timely basis that it is sought only as a matter of last resort. At last week's United States Attorneys' Conference, we emphasized the importance of seeking tax information in all appropriate cases, and outlined the most effective procedures for obtaining disclosure. This briefing will be supplemented by issuance of a new interpretative memorandum. The Department is also considering clarification and updating of the disclosure provisions in the United States Attorneys' Manual. We are optimistic that these training efforts, which will continue in workshops and training sessions for federal prosecutors, will result in more frequent and effective use of Section 6103(i) procedures.

The IRS has also been reviewing and revising its internal disclosure procedures, and has been taking steps to expedite the processing of disclosure requests and court orders. As a result, procedural changes have already been implemented to reduce delays in disclosure. For example, disclosures in response to letter requests can now be made directly to an investigative agent, rather than routing the information through a federal prosecutor. This expedited procedure will be particularly helpful where time is of the essence, e.g., in locating fugitives. In addition, the IRS is now making disclosures of tax information relating to non-tax federal criminal offenses directly to the Criminal Division's Office of Legal Support Services, as agent of the Attorney General. This procedure saves time and reduces the number of Department officials processing the referred information, thus minimizing the potential for inadvertent breaches of confidentiality.

Further, the IRS is preparing to implement two additional measures which will greatly assist this Department in investigating and prosecuting non-tax crimes. First, the IRS will decentralize its disclosure operations, so that court orders will be processed with fewer levels of review. This will greatly expedite compliance with court orders.

In addition, the IRS is now developing procedures and manual revisions to place higher priority on alerting the Department, and other agencies, to the commission of a non-tax crime and to the existence of tax information relevant to that crime. (So alerted, we can then obtain the information using (i)(1) and (2) procedures.) In this connection, we are discussing with the IRS plans for a videotape presentation which could be used for training revenue agents as to the type of non-tax criminal offenses to which they should pay special attention and the nature of the information which can and should be disclosed to the Department.

As you can see, the efforts of the Department and the IRS to improve administrative procedures are proceeding well. In recent months, Commissioner Kurtz, Assistant Attorney General Hymann, myself, and members of our staffs have met frequently to discuss disclosure problems and legislative and administrative solutions. This concentrated effort has resulted in a more precise definition of mutual problems, a better understanding of the problems peculiar to each agency, and a shared commitment to finding administrative solutions wherever possible.

In my opinion, one of the most desirable solutions is to establish an interagency Section 6103 committee, consisting of representatives from the IRS, the Tax Division, and the Criminal Division, the function of which would be to discuss operational problems promptly as they arise and to suggest improvements in procedures. The interagency committee would pay particular attention to problems of interpreting the various terms and phraseology of Section 6103 in an effort to arrive at uniform positions which would then be promulgated to personnel of the respective agencies. In this connection, the IRS is planning installation of a national Section 6103 hotline in an effort to provide field personnel with immediate guidance on interpretative matters.

The IRS is taking steps to reduce substantially the time lag in the flow of tax information after court orders are obtained or letter requests are made under Section 6103(i). The IRS believes that, with decentralization of the disclosure function and additional emphasis placed on expedition, the existing problems can be alleviated.

One final area in which the Department and the IRS agree that administrative procedures must be changed is the authorization of joint tax/non-tax grand juries. Because of the interplay of several factors--grand jury secrecy, confidentiality of tax information, case law in the summons enforcement area, and the Department's dual prosecution policy--joint grand juries are highly desirable, indeed essential, in appropriate cases. However, existing authorization procedures are time-consuming; the resulting delays are substantial and discourage the use of joint grand juries by federal prosecutors.

Pursuant to Rule 6(e) of the Federal Rules of Criminal Procedure, a federal prosecutor, conducting a non-tax grand jury which develops evidence of possible tax or tax-related offenses, is precluded from simply giving such evidence to the IRS for its use in an administrative investigation. Meanwhile, United States v. LaSalle National Bank, 437 U.S. 298 (1978), and its progeny create numerous difficulties for the IRS in promptly obtaining information by means of administrative summonses. These problems are particularly acute in IRS investigations of taxpayers under investigation by non-tax grand juries.

An authorization expanding the grand jury investigation to encompass potential tax offenses in appropriate cases is the only solution to these problems. Investigations of related tax and non-tax offenses should be joined wherever practicable to avoid duplication of time and effort on the part of federal prosecutors and witnesses and to facilitate the development of evidence. Confidential tax information may well constitute evidence of a non-tax offense, just as evidence of a non-tax offense may be relevant to establishing a tax offense. In addition, joint grand jury investigations comport with the Department's policy to avoid successive prosecutions by investigating and prosecuting related federal offenses in one proceeding.

In order to expand a non-tax grand jury into a joint grand jury investigation, giving a federal prosecutor access to confidential tax information, Treasury Regulation Section 301.6103(h)(2)-1(a)(2)(ii) requires that the "tax portion of such proceeding" be referred by the IRS to and be authorized by the Tax Division. This procedure insures supervisory review of the case to determine that there is a legitimate tax administration purpose for the grand jury investigation and prevents the joint grand jury investigation from being used as a subterfuge to circumvent the disclosure restrictions of Section 6103.

Currently, the authorization procedure is as follows. A federal prosecutor conducting a non-tax grand jury investigation contacts the local Chief of the IRS Criminal Investigation Division in order to inform him that the matters under investigation appear to involve significant tax violations, to provide him with information indicating the nature of those violations, and to request that the IRS consider referral of the tax violations for investigaton by the grand jury. If the local Chief determines that the investigation has tax potential and that IRS should provide assistance, his determination must then be reviewed and approved by the District Director, the Regional Commissioner, and Regional Counsel's Office before being referred to the Tax Division pursuant to Section 6103(h).

The Tax Division must review the recommendations of the federal prosecutor and the IRS to determine if there is a legitimate tax administration purpose to justify expansion of the grand jury investigation to include possible tax offenses. If the Tax Division then authorizes a grand jury investigation of the tax offenses, it sends a written authorization to the federal prosecutor to expand the grand jury investigation to include possible tax offenses, designating the subjects and tax years to be investigated and the scope of the inquiry. If, as the joint investigation proceeds, it is determined that additional years or individuals should be included in the investigation, the prosecutor must seek authorization for such expansion using this same time-consuming procedure.

The IRS and the Department of Justice agree that the multiple levels of review in the current authorization process are unnecessarily time-consuming and burdensome. The IRS is revising its procedures in order to streamline the authorization process. The thrust of the proposal is to cut away the layers of review within the IRS for authorization of the grand jury and to provide an expedited procedure for adding new targets and years to ongoing grand jury investigations. The Tax Division is currently studying and preparing comments on the proposal.

In summary, Mr. Chairman, I believe that both the IRS and the Department of Justice are exploring administrative changes which will expand and expedite the proper disclosure and use of tax information in criminal cases. Further changes are needed; further proposals are under consideration. Further meetings between the IRS and the Department are planned. Based on the progress we have made to date and the high priority which both agencies have given this effort, I am confident that we will achieve the fullest cooperation permitted by existing law. Accordingly, I do not believe that specific riders to the Treasury appropriations bill are necessary to secure needed administrative improvements.

Finally, while we obviously favor an increase in IRS resources allocated to the Special Enforcement Program and to disclosure training, the Department of Justice does not have sufficient knowledge of IRS staffing needs to suggest specific resource levels. Moreover, because Commissioner Kurtz is in the best position to know how his limited resources should be allocated to meet the wide range of responsibilities which the IRS bears, we would be most reluctant to propose staffing and resource priorities.

Again, Mr. Chairman, thank you for this opportunity to appear here today.

Mr. FERGUSON. Thank you, Mr. Chairman.

I appreciate the opportunity to appear here today to discuss efforts to improve coordination between the Service and the Department of Justice in investigating and prosecuting nontax Federal criminal cases.

With me is Assistant Attorney General Philip Heymann of the Criminal Division and his Deputy, Irving Nathan of the Criminal Division, and Jerry Feffer of the Tax Division.

At the conclusion of my prepared statement, we will be happy to answer any questions you have.

The Department is committed to effective law enforcement and to achieving the most cooperative efficient working relationship with the Service possible.

IMPEDIMENTS CREATED BY TAX ACT

Mr. Chairman, we know that you share our concern over the impediments to cooperative law enforcement which Congress created in the restrictive disclosure provisions of the Tax Reform Act of 1976. We are pleased this problem will be the subject of a thorough review by Congress and, if necessary, corrective legislation.

The nature and extent of the law enforcement problems which the Tax Reform Act of 1976 created were the subjects of comprehensive testimony by the Department of Justice before Senator Nunn's Permanent Subcommittee on Investigations last December, and there is no need to repeat that testimony today. Instead, I would like to review our recent efforts, working with the Service, to improve existing administrative procedures under the act as it now reads.

Tax information is often essential to successful investigation and prosecution of many serious Federal crimes, particularly organized crime and narcotics trafficking.

Section 6103 of the Internal Revenue Code, however, which was substantially rewritten by the Tax Reform Act of 1976, severely restricts our access to this essential information in nontax cases. Section 6103(i)(1) of the Internal Revenue Code permits disclosure of returns and taxpayer return information only pursuant to a court order which we can only obtain upon the authorization of the Attorney General, an Assistant Attorney General, or the head of a Federal agency.

Section 6103(i)(2) permits disclosure of return information other than taxpayer return information—which essentially means data supplied by someone other than the taxpayer under audit or investigation—only upon written request by a head of a division or other specifically designated agency heads. Section 6103(i)(3) permits the Service to disclose to other Federal agencies, including Justice, on its own initiative, return information other than taxpayer return information only where information may constitute evidence of a crime and only to the extent necessary to apprise us of the crime.

The 1976 revisions to section 6103, of course, reflect Congress' concern for the protection of individual privacy. We believe, however, that some amendments may be necessary now to achieve a more appropriate balance between individual privacy interests in tax information and law enforcement interests in that same information.

ADMINISTRATIVE IMPROVEMENTS POSSIBLE

In the last several months, we have been working with the Service to develop such amendments. However, there are administrative steps that we can take right now to improve procedures and performance under the law as it now reads, and my remarks today will try to bring you up to date on our current efforts, working with the Service, to formulate some of those needed administrative improvements under the current law.

There have been frequent meetings, of course, between the Service and Justice representatives since the Tax Reform Act of 1976 was enacted. The early stages of these meetings focused primarily on the need to comply with rather complex and technical provisions of the act. Only recently have we begun to move beyond this basic implementation to look at some of the problems which have resulted, in our experience, and hopefully which can be resolved even if the law cannot be amended. It was not until 1979 that we and the Service were really able to get a detailed and informed analysis of the problems which have worked their way up in the course of trying to live with the new law.

I would like to describe some of the changes in procedure which we have initiated as a result of those meetings and as a result of the experience we have had to date.

DISCUSSION OF ADMINISTRATIVE CHANGES MADE

First, in March 1979, the Criminal Division revised its procedures for processing applications for court orders under 6103(i)(1) and information requests under (i)(2). Previously those applications were processed by the various sections of the Criminal Division which had jurisdiction over the substantive offenses being investigated or prosecuted. For example, when the U.S. attorney's office needed tax information in an organized crime case, the application was forwarded to the organized crime and racketeering section which processed it for the Assistant Attorney General's required authorization. Bear in mind, all those authorizations under the law must be made by the Assistant Attorney General himself.

In March 1979, this processing function was centralized within the Criminal Division in the new Office of Legal Support Services so that all applications for tax information under section 6103(i) are now processed by the same attorneys who are disclosure specialists.

The Service also has changed its procedure to accommodate our centralization. Not only does centralization expedite our internal procedures, but it insures that the papers we prepare and forward to the Service are prepared uniformaly and thus can be reviewed faster by the Service. In addition, our disclosure attorneys deal regularly with the Service disclosure officials, with the result that they come to understand each other's problems. The result is improved performance, less confusion and reduction in delays in processing.

Second, turning from the Criminal Division to the field, we have encouraged all U.S. attorney's offices to make more frequent and effective use of the 6103(i) procedures.

There are many cases in which tax information can properly be obtained to strengthen the Government's evidentiary showing, whether or not it is absolutely necessary to satisfy the burden of proof. However, the restrictive provisions and procedures under the act have so frustrated many Federal prosecutors that they view tax information as so difficult to obtain on a timely basis that it is sought only as a matter of last resort.

TRAINING FOR U.S. ATTORNEYS

Last week we had our annual meeting of all U.S. attorneys throughout the country here in Washington. At that time, we emphasized again the importance of seeking tax information in all appropriate cases and outlined the most effective procedures for obtaining disclosure. Commissioner Kurtz joined us at the presentation and addressed the conference on the same subject of tax return disclosure, one which I know he is as deeply concerned about as are we in the Department. We are supplementing this presentation by the issuance of a new interpretive memorandum to all U.S. attorneys, and we are planning to clarify and update the disclosure provisions in the U.S. attorney's manual accordingly. We hope these efforts, which will continue in workshops and training sessions for assistant U.S. attorneys and other prosecutors, will result in more effective use of section 6103(i) procedures.

IRS ADMINISTRATIVE REFORMS

The Service has also been working to revise its internal disclosure procedures and has been taking steps to expedite the process of handling disclosure requests and court orders. As a result, procedural changes have already been implemented to reduce delays in disclosure. First, the Service has changed their method of handling disclosures in response to letter requests. These can now be made directly to an investigative agent rather than having to be routed through Federal prosecutors. This procedure, I think, will be particularly helpful where time is of the essence, as in the case of locating fugitives.

Second, the Service is making disclosure of tax information relating to nontax Federal criminal offenses directly to the Criminal Division's Office of Legal Support Services, that new centralized office I just mentioned, as an agent of the Assistant Attorney General. This cuts down the number of hands through which the requests and responses must pass and I think will minimize the potential for inadvertent breaches of confidentiality.

Further, the Service is preparing to implement two additional measures which will greatly assist the Department in investigating and prosecuting nontax crimes. First, the Service will decentralize its disclosure operations in much the manner the GAO suggested to the committee, so the court orders will be processed through fewer levels of internal review. We hope this will greatly expedite compliance with court orders.

Additionally, the Service is developing procedures and manual revisions to put a higher priority on alerting us and other agencies to the commission of nontax crimes and to the existence of tax information relevant to those crimes. Once alerted, of course, we can obtain the information by using the procedures set out in section 6103(i) (1) or (2). In this connection, we are discussing with the Service a possible videotape presentation which can be used for training revenue agents as to the type of nontax criminal offenses which they should pay special attention to and the nature of the information which we should have.

IRS/JUSTICE COOPERATION

As you can see, the efforts of the Department and the Service are coming along. In recent months, Commissioner Kurtz, Assistant Attorney General Heymann, myself, and members of our staffs have met frequently to discuss disclosure problems and legislative as well as administrative solutions. Our efforts have resulted, I think, in a better understanding of our mutual problems and a shared commitment to find administrative solutions wherever possible.

Perhaps one of the most desirable solutions would be the establishment of an inter-agency section 6103 committee consisting of a representative from the Tax Division, another from the Criminal Division, and representatives from the Service. Its function would be to discuss operational problems promptly when they arise and to agree upon improvements in handling requests.

We have reached an agreement in principle to establish such a committee just last week. I believe it will pay particular attention to problems of interpreting various terms and phraseologies of section 6103 and it will permit us to arrive quickly at uniform positions which would then be promulgated to personnel in both agencies. In this connection, the Service is planning installation of a hot line accessible to all of its employees to receive section 6103 information and immediate guidance on interpretative matters from Washington.

The Service is taking steps to reduce substantially the time lag in the flow of tax information after court orders are obtained or letter requests made under section 6103(i). They tell us that, with decentralization of the disclosure function and additional emphasis placed on expedition, the existing problems of delay can be alleviated.

JOINT GRAND JURIES

One final area in which we and the Service agree that administrative procedures must be changed is in the authorization of joint tax/non-tax grand juries. Because of the interplay of several factors—grand jury secrecy, confidentiality of tax information, case law in the summons enforcement area, and our dual prosecution policy—joint grand juries are essential in appropriate cases. Existing authorization procedures, however, are time-consuming. The resulting delays are substantial and discourage the use of joint grand juries by Federal prosecutors.

Pursuant to rule 6(e) of the Federal Rules of Criminal Procedure, a prosecutor conducting a non-tax grand jury which develops evidence of possible tax offenses is precluded from simply giving the evidence to the IRS for its administrative use. Meanwhile, the *LaSalle National Bank* case and its progeny have created several difficulties for the

Service in promptly obtaining information by means of administrative summonses. These problems are particularly acute in IRS investigations of taxpayers under investigation by non-tax grand juries.

An authorization which expands a grand jury investigation to encompass potential tax offenses is the only solution to these problems. Investigations of related tax and nontax offenses really must be joined wherever practicable to avoid duplication of time and effort on the part of Federal prosecutors and witnesses and to facilitate the development of evidence. Confidential tax information may well constitute evidence of a nontax offense, just as evidence of a nontax offense may be relevant in establishing a tax offense.

In addition, joint grand jury investigations comport with the Department's policy of avoiding successive prosecutions by investigating and prosecuting related Federal offenses in one joint proceeding.

In order to expand a nontax grand jury into such a joint grand jury investigation, the Treasury regulations require that the tax portion of such proceeding be referred by the Service to the Tax Division for authorization. This insures supervisory review of the case to make sure there is a legitimate tax administration purpose for the grand jury investigation and, of course, prevents the use of a joint grand jury investigation as a subterfuge to circumvent the disclosure restrictions of section 6103.

Currently, the authorization procedure within the Service is multiplicitous and prolonged, as was just described in detail by representatives of GAO.

Once we have received the referral from the Service, the Tax Division must review the recommendations of the Federal prosecutor and the Service to determine if there is a legitimate tax purpose. When authorized by the Tax Division, the Federal prosecutor may then expand the grand jury investigation to include possible tax offenses, designating subjects and tax years to be investigated and the scope of the inquiry. If, as the joint investigation proceeds, it is determined that additional years or individuals should be included within the tax investigation, the prosecutor must seek authorization for such expansion using the same time-consuming procedure which GAO described earlier this morning.

The Service agrees with us that the multiple levels of review in the current authorization process are unnecessarily time-consuming and burdensome. The Service is revising its procedures in order to streamline the authorization process. Whether district counsel or regional counsel is the appropriate reviewing officer within the Service, I think, is a matter which the Service has yet to work out. I think, as GAO indicated this morning, we should await their report before trying to evaluate how much can be done. In any event, certainly some of the layers of review within the Service should be cut away and the whole process streamlined.

SUMMARY

In summary, Mr. Chairman, I believe that both the Service and Justice are exploring administrative changes which will expand and expedite the proper disclosure and use of tax information in criminal cases. Further changes are needed. Further proposals are under consideration. And meetings between the Service and Justice are planned and will go forward.

Based on the progress we have made to date, and the high priority which both agencies have given this effort, I think we are working to achieve the fullest cooperation permitted by existing law. Accordingly, I do not believe that specific riders to the Treasury appropriations bill are necessary to secure needed administrative improvement.

Finally, while we favor an increase in IRS resources allocated to the special enforcement program and to disclosure training, we do not have sufficient knowledge of the Service's staffing needs to suggest specific resource levels. Moreover, because Commissioner Kurtz is in the best position to know how his limited resources should be allocated to meet the wide range of responsibilities which the Service bears, we would be most reluctant to suggest specific staffing and resource priorities.

Again, Mr. Chairman, thank you for this opportunity to appear today. We will be happy to answer any questions.

Senator CHILES. Mr. Heymann.

Mr. HEYMANN. I have no statement, Mr. Chairman. I am just here to help answer questions and help my friend, Mr. Ferguson.

ABSENCE OF MR. NATHAN

Senator CHILES. Mr. Nathan was introduced. Is he here?

Mr. HEYMANN. Mr. Nathan was here in case I didn't get here in time. He went back, Senator Chiles. When I got here, he left.

Senator CHILES. We want Mr. Nathan to know he is welcome here. We are still glad to hear from him at any time he is able to speak.

Mr. HEYMANN. He knows it, and he has no hesitancy about speaking, Senator Chiles.

Senator NUNN. The question is whether others have hesitancy about his speaking.

Mr. HEYMANN. It doesn't really make much difference, Senator Nunn. I have no hesitancy about it. No one ever attempts to bridle the highly intelligent, highly articulate, irrepressible Mr. Nathan, I promise you.

MISUSE BY JUSTICE OF TAX INFORMATION

Senator CHILES. Are you all aware of any incidents, either before or after passage of the Tax Reform Act of 1976 in which officials of the Department of Justice have misused information obtained from IRS?

Mr. FERGUSON. I am not, Mr. Chairman. I think there may have been a few times early on with this new law when tax returns had been obtained by U.S. attorneys for voir dire purposes, and perhaps to cross-examine witnesses. I do not believe there has been any abuse. At most I would call it over-use of return information.

Senator CHILES. Mr. Heymann?

Mr. HEYMANN. I know of no such examples, Mr. Chairman, and we have looked.

Senator CHILES. I take it, then, no cases have come before your Internal Security Division people?

Mr. HEYMANN. I believe not. I would have to check to be sure, but we thought about it and have not found those cases.

SELECTED TAX ACT EXEMPTIONS FOR IRS

Senator CHILES. I want to repeat the question I was asking GAO. Do you believe it is desirable to totally exempt IRS from disclosure provisions of the Tax Reform Act of 1976 as it relates to the investigation of class I criminals?

Mr. FERGUSON. Mr. Chairman, I think there are some competing policies here. While a complete exemption may be unwarranted, I do think it would be most helpful to have legislation to provide a speedy, simple procedure that will allow comfortable agent-to-agent contact so we do not have this——

Senator CHILES. In addition to that, though, shouldn't there be some requirement that an IRS agent should notify the authorities if he comes across the provisions of a crime even in a tax return?

Mr. HEYMANN. I think the precise area you ask about, Mr. Chairman, is the hardest area. Let me get to it only after a couple of sentences.

When we have an investigation going in the Justice Department, we have to be able to and should be able to get taxpayer return information—including returns and books and records—quickly and effectively. I think Mr. Kurtz agrees—I am sure Mr. Kurtz agrees with that. It is taking us some 60 days now. We have to turn that around. We can't be asked to prove what is in the tax return in order to request the tax return, because we don't know what is in it until we get it. That is when we have an investigation going.

When the IRS has information from third parties of any sort, information that does not come from tax returns or books and records, it seems to me that that information is no different from information that Customs has, which Senator Schmitt asked about earlier, or DEA has, or FBI has. It comes from third parties and not taxpayers' books and records. It ought to be readily available, not just for class I criminals, but in the case of any criminal. They ought to be able to turn it over. The crucial thing there is it has to be done quickly, informally and we have to be able to work out an arrangement whereby an organized crime strike force or narcotics group in the field can quickly get that information. This applies to information we request under (i)(2).

The hardest question is the one you ask: What if we do not have an investigation going, but the Internal Revenue Service can tell from a taxpayer's return or books and records that there is information there that bears on a title XVIII violation? It is, frankly, a tough question. We want full disclosure for tax purposes in books and records and on returns. Yet, it seems, as you suggest, outrageous the IRS would know it and not turn it over.

We do not have agreement on this. There are a variety of ways that it can be cut. One way you could cut it is to make a distinction in terms of corporate books and records, saying corporate books and records do not enjoy the protection when they reveal a title XVIII crime but an individual's books and records do. That seems to me to be, perhaps, an extremely difficult issue with strong policies cutting both ways that we will discuss today.

PUBLIC POLICY REGARDING RELEASE OF TAX INFORMATION

Senator CHILES. Would that not be an area in which the Congress, who develops the public policy, could well speak as to what they feel the public policy of the land should be?

Mr. HEYMANN. Obviously, Congress can speak on that and can choose it as it wishes. The same taxpayer's books and records which are now protected if we don't have an investigation going, of course, are disclosed and not protected—despite whatever expectation the taxpayer had when he filed his tax return—in the case when we have an investigation going and can make out a request for an (i)(1) order.

Senator NUNN. A grand jury?

Mr. HEYMANN. Even without that. If we have an investigation going and if we have some basis for believing the returns might help, we can get them under (i)(1). Commissioner Kurtz and I and Carr Ferguson agree the procedures are too cumbersome now. We need statutory changes there, we need administrative changes, but we can, if we have an investigation going, get taxpayers' returns, plus their books and records.

The only tough, knotty question is the one that Senator Chiles has. When we do not have an investigation going, when we do not know about the matter and when the Service has obtained the information from the taxpayer's return or books and records, not from third parties, what should happen then? I think it is something that could go either way. At the moment, the administration's disposition is not to suggest an obligation on the Service to turn information over in that situation.

QUESTIONNAIRE TO U.S. ATTORNEYS ON TAX ACT

Senator CHILES. I understand the Department recently distributed a questionnaire concerning the impact of the Tax Reform Act on all U.S. attorneys in strike force offices throughout the country. Has the Department completed this field survey?

Mr. FERGUSON. We have completed the review of responses to those questionnaires. We have been working for a couple of weeks now, Mr. Chairman, assembling the information and trying to develop it into a final report, which we can release back to the U.S. attorneys. We have gone far enough, however, I think, to make a couple of initial observations.

Senator CHILES. We would like to have any comments you can make at this time. Of course, we would like to have a copy of the report.

Mr. FERGUSON. We will be glad to submit a copy of the report when it is finalized. I guess that will be a few more weeks, but we will submit it when it is available.

[The information follows:]

REPORT OF THE RESULTS OF THE TAX DIVISION'S SURVEY REGARDING THE IMPACT OF 26 U.S.C. 6103 (AS AMENDED BY SECTION 1202 OF THE TAX REFORM ACT OF 1976) ON THE LAW ENFORCEMENT ACTIVITIES OF THE DEPARTMENT OF JUSTICE

PREFACE

As indicated in the report that follows, 123 offices were asked to complete the questionnaire, and 105 of the offices, or 85 percent, responded by February 26, 1980. With respect to civil tax and criminal tax cases, the survey results reveal that prosecutors have had difficulty in obtaining from IRS tax information in addition to that supplied by IRS at the time the tax matter was referred to the Department of Justice under 26 U.S.C. 6103(h)(3)(A). These difficulties consisted of delays, as well as disagreements with IRS over whether the additional information sought could be disclosed to the Government attorney.

With respect to non-tax cases, most offices have desired access to tax returns and return information for use in non-tax criminal investigations or prosecutions. Approximately 28 percent of the offices desiring tax returns or taxpayer return information for such purposes indicated that they decided not to use Section 6103(i)(1) to obtain the information. Most of these offices stated that they did not use procedures under Section 6103(i)(1) because they were too cumbersome and/or time-consuming. Two offices stated they did not believe they could make the requisite showing under Section 6103(i)(1)(B).

Of the 54 offices that reported having used Section 6103(i)(1), about one-fourth used these procedures only once or twice, and then ceased using them because the procedures were viewed as too cumbersome and/or too time-consuming, or because these offices did not believe they could make the requisite showing under Section 6103(i)(1)(B).

The average time needed in 1979 to obtain Department authorization to apply to the court for an order under Section 6103(i)(1) was 24.2 days, as compared with 25.8 days in 1977. The average time needed in 1979 to obtain the tax information from IRS once a court order had been obtained was 41.6 days, as compared with 67.2 days in 1977. This data is based on reported time periods which were labeled by the responding offices according to the year in which their requests were submitted to either IRS or the Department of Justice. For reported time periods which were not labeled by the respondents according to year, the average time needed to obtain Department authorization to seek an order was 31.7 days, and the average time needed to obtain the tax information from IRS was 44.5 days.

Four offices of the 54 which sought Section 6103(i)(1) orders reported that their applications for orders were denied by the court. In two of these cases, the court did not believe it appropriate to grant an ex parte order during the course of a trial. One court did not believe the Government had made the showing required by Section 6103(i)(1)(B).

Of the 62 offices desiring access to return information, 40 actually used the procedures under Section 6103(i)(2) for obtaining this information from IRS. Most of the 22 offices which reported they did not use procedures under Section 6103(i)(2) indicated that the procedures are too cumbersome and/or too time-consuming to justify the effort. One office complained that it did not believe it could make the requisite showing for obtaining the information from IRS. Of the 40 offices which used the procedures under Section 6103(i)(2), one-half of these offices indicated they had encountered problems in using the procedure. Of the 20 offices which reported difficulties, 12 offices complained either of delays in obtaining the information from IRS, or that the procedures are too cumbersome. Other offices noted they had encountered disagreements with IRS regarding whether certain types of information could be disclosed to the Government attorney under 6103(i)(2).

From the time the Criminal Division forwards a request initiated by a Government attorney for disclosure under 6103(i)(2) to IRS, the responding offices reported that the average time which lapsed in 1979 before the Government attorney received the requested return information from IRS was 56.2 days, as compared with 101.6 days in 1977. This data is based on reported time periods which were provided by the respondents and labeled according to the year in which they submitted their requests to the Criminal Division for forwarding to the IRS. For reported time periods which were not labeled according to year, the average time needed to obtain the information from IRS, from the time the Criminal Division forwarded the request to the Revenue Service, was 59 days.

With respect to disclosures by IRS under Section 6103(i)(3), the results of the survey indicate that only a small minority of federal prosecutors have received information from IRS under these provisions. Those offices which have received such return information differed regarding whether they viewed the information as useful to the law enforcement efforts of their respective offices: in some cases, the respondents reported that the information was of little or no value, whereas other offices characterized the information as extremely helpful.

As indicated in Section V of this report, some of the questions on the survey related to the use of procedures for expanding ongoing non-tax grand jury investigations to include investigations of alleged tax offenses. Over one-half of the offices responding to the survey indicated that, after developing evidence during the course of a non-tax grand jury investigation of potential tax violations, they used the procedures for obtaining IRS-Tax Division authorization to expand the inquiry to include the investigation of tax offenses, thereby having such inquiry deemed a joint investigation having tax administration purposes, in accordance with 26 C.F.R. 301.6103(h)(2)-1(a)(2). The experiences reported by these offices indicate that a significant number have encountered delays in obtaining authorization to expand an ongoing non-tax grand jury investigation to include an investigation of alleged tax offenses, and/or delays in seeking authorization to expand the scope of the tax inquiry to include additional tax years and/or additional targets. Some offices noted that these delays are attributable to the multi-level review of such requests within IRS. From the time a request for authorization to expand a non-tax investigation to include an investigation of alleged tax offenses was submitted by the Government attorney (either through IRS channels or directly to the Department), the average time which lapsed in 1979 before authorization was received by the Government attorney was approximately 3.6 months (113 days). This data is based on reported time periods which were labeled by the responding offices according to the year in which they submitted their requests. For reported time periods which were not labeled according to the year that the request was submitted, the average time was approximately 3.5 months.

The results of the survey clearly indicate that the existing procedures for obtaining authorization to conduct and expand joint tax/non-tax grand jury investigations must be streamlined. In addition, the results show that IRS and Department procedures for obtaining tax information under Sections 6103(i)(1) and 6103(i)(2) must be expedited, and that disclosures of return information to Government attorneys for non-tax purposes should be made by IRS more frequently, to the full extent permitted by Section 6103(i)(3). The survey also indicates that the Department must take steps to better educate its prosecutors regarding both the provisions of Section 6103 and applicable regulations thereunder, as well as the ways in which the statute can be used to obtain needed tax information either for tax administration purposes, or for the investigation and prosecution of non-tax criminal matters.

I. INTRODUCTION

The purpose of this paper is to report the results of a survey conducted by the Tax Division regarding the impact of 26 U.S.C. 6103 (as amended by Section 1202 of the Tax Reform Act of 1976) on the law enforcement activities of the Department of Justice. This survey was conducted by means of a questionnaire developed by the Tax Division and forwarded to all United States Attorneys and the Organized Crime Strike Forces in late November, 1979. Questionnaires were also distributed in mid-December, 1979 to all attorneys in the Tax Division and to the Chiefs of the Sections of the Criminal Division.

This report begins with a discussion of methodology, which outlines the theory underlying the questionnaire, and explains how the responses were tabulated. The methodology section also contains an important note regarding the limitations of the survey and the data it produced.

Sections III through V relate to the results of Parts III and IV of the survey. Each section pertains to one of the three categories of cases or investigations regarding which we sought information--tax cases, nontax criminal cases, and joint tax/nontax criminal cases. These sections report the results by quantifying the data as percentages of the number of responses received. In addition, where Government attorneys reported difficulties in utilizing 26 U.S.C. 6103 to obtain tax information, these difficulties are set forth with as much detail as possible.

Section VI of this report documents the survey results with respect to two "miscellaneous" sections of the questionnaire, one of which relates to difficulties in obtaining state tax information from states which have adopted disclosure laws similar to Section 6103.

Section VII of this report summarizes the responses of the replying offices to the open-ended request in Part V of the questionnaire, which requested comments and additional information regarding the impact of Section 6103 on the Department's law enforcement activities.

The final section of this report, Section VIII, contains supporting exhibits, and includes a copy of the questionnaire.

A complete set of data may be found in Room 4645. The originals of the questionnaires have been retained by Ms. Deborah A. Wright, Special Assistant to the Deputy Assistant Attorneys General, in Room 4135. It should be noted that the responses on file in Room 4645 and Room 4135 may contain taxpayer return information, return information, or information which could be considered as falling within the disclosure restrictions of F.R. Crim.P. 6(e). Access to these materials should be restricted accordingly.

II. METHODOLOGY

A. The Questionnaire

1. Length

The questionnaire drafted by the Tax Division for use in the survey of Department of Justice attorneys (attached to this report as Exhibit #1) was designed to obtain as much detail as possible regarding the impact of Section 6103 on the Department's law enforcement activities. The questionnaire, reproduced on legal-size paper, was 12 pages long, and contained a total of 60 questions, many of which were "follow-up" inquiries to initial, basic questions.

There is a possibility that the very length of the questionnaire may have had an adverse impact on some of the respondents--perhaps one is more likely to answer "no" so that one can proceed to the next section rather than answer "yes" and then face all of the follow-up questions asking for details. However, in view of the definitional and procedural complexities of Section 6103, we decided that the only way to obtain statistically valid data was to pattern the questionnaire after the statute. The alternative was to ask brief, open-ended questions and risk vague answers that would require extensive telephone contact later in order to develop usable data.

2. Substance

The questionnaire was divided into five parts. The first contained instructions, and the second section requested identifying data such as the Government attorney's name, title, office, and telephone number. The third section contained structured questions relating to experiences with Section 6103 in tax cases--"matters involving tax administration." The fourth section was also structured and related to the use of Section 6103 in nontax criminal cases. Both Parts II and IV of the survey contained questions relating to joint tax/nontax criminal cases. Parts III and IV thus generally reflected the distinction between Section 6103(h) ("matters involving tax administration") and Section 6103(i)("matters involving the enforcement of nontax federal criminal laws"). Part V consisted of one open-ended question soliciting comments regarding the impact of Section 6103 on the respondents' law enforcement activities. The terms "returns," "taxpayer return information," and "return information" were used in the questionnaire in the way they are defined in the statute. All of this was explicitly stated in the instructions for the survey.

The questions in Parts III and IV of the survey were usually two-pronged: Did the attorney ever need certain tax information in connection with a particular type of case or investigation, and, if so, was Section 6103 utilized successfully to obtain that information? By utilizing this pattern, it was possible to avoid unduly weighting responses showing that Section 6103 procedures were rarely used, where such answers were directly attributable to the fact that tax information was not needed in the first place. This approach also helped to identify and eliminate responses from attorneys who, for example, do not handle nontax criminal cases, and therefore have no occasion to use Section 6103(i).

Once the form of the structured questions was thus determined, there was the problem of what specific questions to ask. In large part, the questions to be asked were suggested by the procedures established by the Department of Justice and the Internal Revenue Service for the utilization of Section 6103. In such cases, the questions chosen were designed to test the effectiveness and efficiency of those procedures. Other questions, however, related solely to the statute--e.g., inquiries regarding the introduction of tax returns into evidence in a judicial proceeding. These questions were drafted after a careful review of the legislative history of the 1976 amendments to Section 6103, and were designed to determine whether the provisions some had viewed in 1976 as a potential hindrance to the Department's investigative efforts had actually turned out to be such an impediment after the statute had been in operation for almost three years.

Finally, we asked a few questions to which we thought we already knew the "answers." For example, in Part III, attorneys were asked to list cases in which, to their knowledge, Section 6103(h)(3)(B) had been utilized. Of course, since this provision requires a written request for disclosure from an Assistant Attorney General, we presumably already know of the cases in which this procedure has been utilized. However, this question served two useful purposes. First, it was designed to alert us to any additional cases in which the procedure had been used. Secondly, and more importantly, the question indirectly operated as a measure of the responding attorney's familiarity with and understanding of the statute: to the extent that this question was answered "incorrectly" by using as an example a joint tax/nontax case where the procedures under the joint investigation regulation (26 C.F.R. 301.6103(h)(2)-1(a)(2)) had been used, it alerted us, in evaluating the data provided by that attorney, to the fact that the respondent had confused the provisions of Section 6103(h)(3)(A) with Section 6103(h)(3)(B).

B. Distribution of the Questionnaire

By letter dated November 21, 1979, M. Carr Ferguson, Assistant Attorney General, Tax Division, and Philip B. Heymann, Assistant Attorney General, Criminal Division, requested each United States Attorney's office and each Organized Crime Strike Force to complete the questionnaire and return it to the Tax Division by December 21, 1979. This letter is attached as Exhibit #2. These letters and accompanying questionnaires were mailed from the Tax Division on November 22 and November 23, 1979. In addition, by memorandum dated December 28, 1979, Mr. Ferguson requested that all attorneys in the Tax Division complete the questionnaire and return it by January 15, 1980. (See Exhibit #3.) These questionnaires and memoranda were given to the Chiefs of the respective Sections in the Tax Division for distribution to their attorneys.

In addition, writer has been informed by Mr. Bruce Peterson of the Criminal Division that Deputy Assistant Attorney General Irvin Nathan did not distribute the survey to all attorneys in the Criminal Division; instead, the questionnaires were forwarded to the Section Chiefs, who were asked to have them completed by attorneys in their respective Sections who have had experience with Section 6103. (Following the recent reorganization of the Criminal Division, the Criminal Division now has seven "Sections" as opposed to "Offices": Appellate, Fraud, General Litigation and Legal Advice, Internal Security, Narcotics and Dangerous Drugs, Organized Crime and Racketeering, and Public Integrity.)

To encourage all offices to complete the survey, on January 17, 1980, a follow-up letter was sent by Gerald A. Feffer, Deputy Assistant Attorney General, Tax Division, to the United States Attorneys' offices and Strike Forces which had not yet responded, requesting that the completed questionnaires be submitted no later than January 31, 1980, in order that the responses could be analyzed as soon as possible. (See Exhibit #4.)

A total of 123 offices were asked to complete the questionnaire. This total includes the 94 United States Attorneys' offices, the 13 Strike Forces, the Dallas Field Office of the Criminal Division, the seven Sections of the Criminal Division, and the eight Sections of the Tax Division.

C. The Return

By February 26, 1980, a total of 355 responses to the survey were received. These responses were submitted by 105, or 85%, of the 123 offices polled. Responses were received from:

84 of the 94 United States Attorneys' offices
10 of the 13 Strike Forces
All of the Tax Division's 8 Sections
The Dallas Field Office of the Criminal Division
2 of the Criminal Division's 7 Sections

Most of the offices polled each submitted one questionnaire in response to the survey. However, the Southern District of New York disseminated the survey to the 75 attorneys in its Criminal Division, 40 of whom submitted questionnaires. The Eastern District of New York disseminated the questionnaire to all its Assistants (total number unknown), 36 of whom sent in questionnaires. The Brooklyn Strike Force returned a total of four questionnaires. Finally, the Northern District of Illinois submitted 13 questionnaires; the District of Columbia submitted 4; and the Southern District of Texas submitted 2. The Dallas Field Office of the Criminal Division and the New Orleans Strike Force submitted one questionnaire as the response of both offices. A total of 167 questionnaires were received from Tax Division attorneys: 31 from the Appellate Section; 19 from Civil Trial - Central; 17 from Civil Trial - Northern; 14 from Civil Trial - Southern; 18 from Civil Trial - Western; 20 from the Court of Claims Section; 34 from the Criminal Section; and 7 from the Review Section. The Fraud Section of the Criminal Division submitted 3 questionnaires, and 2 were received from the Public Integrity Section of the Criminal Division.

D. Analyzing the Responses

The following is a summary of the basic procedures used to tabulate and analyze the responses.

1. Determining the Size of the Response Pool

The first step was to determine the size of the response pool for questions relating to tax cases (Part III of the questionnaire) and for questions relating to nontax cases (Part IV of the questionnaire), by eliminating from the original pool of 105 responding offices those that have had no occasion to utilize Section 6103, either because the offices have never needed to obtain tax information, or because the offices do not handle the types of cases regarding which we sought information.

For questions relating to tax cases, this screening resulted in the elimination of 5 offices, making the size of this response pool 100 offices. Here the two responding Sections from the Criminal Division were eliminated, since these offices do not handle tax cases. In addition, the responses from the District of Guam (where United States income tax law does not apply), the District of Puerto Rico (where it has not yet been necessary to use Section 6103 since residents of Puerto Rico normally do not have to file tax returns with the I.R.S.), and the District of Maine (where the United States Attorney's office has not yet had occasion to utilize Section 6103) were also eliminated from the response pool regarding tax cases.

For questions relating to nontax cases, 11 offices were eliminated: the District of Guam, the District of Puerto Rico, and the District of Maine (for the reasonsindicated above), and the 8 Sections of the Tax Division, which do not handle nontax matters. Thus, the number of offices in the response pool for nontax cases is 94.

In calculating the sizes of both response pools, a number of responses were eliminated from the 40 questionnaires submitted by the Southern District of New York, the 36 submitted by the Eastern District of New York, and the 167 submitted by the Tax Division. However, the elimination of these individual responses did not result in the exclusion of these offices from the two response pools, since a sufficient number of "usable" replies still remained for each of these offices.

2. Substantive Analysis

The second step was to read through each reply to make sure that the respondents had understood the questions asked, and had not made errors in classifying responses. For example, some attorneys clearly forgot to answer a few initial questions, since they discussed the items referred to in the initial questions in their responses to follow-up questions. Other respondents incorrectly referred to a joint tax/nontax criminal investigation as a criminal tax case. In such cases, the errors were corrected when the responses were recorded. However, corrections were not made unless it was completely clear from the rest of the questionnaire that an inadvertent omission or error had been made. In all other cases, the responses were recorded exactly as given on the questionnaire.

A relatively simply procedure was used to record the responses. First, the questions on the survey were copied, one to a page, on separate sheets of paper. In the case of structured questions, the sheets were divided into "yes" and "no" columns, or whatever choices were offered in the survey. Each response was then read and the individual answers were recorded on the sheets under the appropriate column by listing the name of the responding office.

As noted above, the Eastern and Southern Districts of New York, the Brooklyn Strike Force, the Northern District of Illinois, the District of Columbia, and the Southern District of Texas chose to submit individual replies rather than a single response representative of their respective offices. In addition, individual replies were also received from attorneys in the Tax and Criminal Divisions. These individual responses had to be analyzed separately in order to avoid producing lopsided results by treating these 266 individual responses, which were representative of only 14 offices, as "equal" to the single responses submitted by 89 other offices. As a result, separate composite records were used to tabulate the individual responses, and the results of these analyses were then recorded on the master collation sheet. In order to record fairly the experience of these offices with Section 6103, an affirmative response from only one Assistant or Department attorney was sufficient to place the entire office in the group of offices which had replied affirmatively to that particular question. For example, the Southern District of New York was counted as being among those offices who have had problems with the Section 6103(i)(2) request procedures if at least one Assistant from the Southern District had had such a problem.

The responses to the open-ended questions varied in the issues discussed and the positions taken. These responses were separated out from the structured data and analyzed and recorded individually. Open-ended comments were not grouped together and quantified unless they related to a single issue and expressed the same point of view. The responses that could not be grouped in this fashion are described separately below. (See Section VII.)

E. Limitations of This Survey

At the time the questionnaire was drafted, every effort was made to insure that all the questions were stated clearly. Of course, it is inevitable in a survey of this type that some questions may not be clear to some respondents, and may be answered based upon misinterpretations of what information is being sought. However, unless an omission or error was obvious, it was impossible to correct it when recording the responses. To the extent that this contingency has affected the results reported below, it should be noted.

Secondly, no controls were placed by this office on which Assistants or Department attorneys were selected by the offices that were polled to complete the questionnaires on behalf of those offices. In the case of the United States Attorneys' offices, most of the questionnaires were clearly completed by an Assistant who handles tax or nontax criminal matters for his/her office, or were completed personally by the United States Attorneys. However, in some cases, it was not clear whether the responding Government attorney handled such cases, and this may have affected the extent to which that office's experience with Section 6103 was fully reported. For example, some Assistants reported that their offices have had no experience with joint tax/nontax criminal cases, even though this office's records reflect that these offices have, on a number of occasions, requested authorization to expand an ongoing grand jury investigation of nontax crimes to include an investigation of potential tax offenses. In such cases, it was impossible to determine whether this was either an error in completing the relevant question, or the result of the responding attorney's lack of knowledge regarding or experience with these types of investigations. In addition, a number of Assistants in the larger Districts, such as the Southern and Eastern Districts of New York, who, based on their contacts with this office regarding specific cases, are known to have utilized certain procedures under Section 6103, failed to submit questionnaires. As a result, the actual experience of these and possibly other offices with the statute may be more extensive than it would appear from the responses submitted by their attorneys.

Finally, as noted earlier, the responses reported below have been quantified as percentages of the number of responses in the pool for tax cases, or the pool for nontax cases, whichever is appropriate. For example, if 50% of the offices in the response pool for nontax cases (a pool which consists of 94 offices) reported having utilized a procedure under Section 6103, this figure represents one-half of the offices in the response pool under discussion, or 47 offices. Thus if, of this 50%, about 19% encountered difficulties using that procedure, this does not mean that 19% of all the offices polled had problems with that part of the statute; rather, it indicates that of the 47 offices which used the procedure, nine offices (or 19%) encountered difficulties. As a result, it is important to keep in mind that many of the percentages reported below--including "deceptively large" percentages--are actually fractions of other fractions, and may represent a far smaller number of offices than might be suggested by a cursory glance at the figures.

III. REPORT OF THE RESULTS REGARDING THE IMPACT OF SECTION 6103 ON TAX CASES (PART III OF THE QUESTIONNAIRE)

Part III of the questionnaire sought information regarding five areas in which Section 6103 could impact on tax cases--i.e., "matters involving tax administration." In all such cases, tax returns, taxpayer return information, and return information are disclosed to Department of Justice attorneys under the referral provisions of 26 U.S.C. 6103(h)(3)(A) and 26 U.S.C. 6103(h)(2), when the matter referred involves "tax administration," as defined in 26 U.S.C. 6103(b)(4).

A. Obtaining Tax Information In Addition to The Information Supplied by IRS At the Time the Matter Was Referred

First, we asked whether the offices polled had ever needed to request from IRS tax returns, taxpayer return information, or return information, for tax administration purposes, in addition to the information that was supplied by IRS at the time the matter was referred to the Department of Justice under Section 6103(h)(3)(A). Those offices that needed such additional information were then asked to indicate whether they had encountered any difficulties in obtaining this information from IRS. Details regarding any problems were requested. [This information relates to questions #1 - #7 of Part III of the questionnaire.]

Response:

Of the 100 offices in the response pool for tax cases, 45% (or 45 offices) indicated that they needed to obtain information from IRS for tax administration purposes, in addition to the information supplied by IRS at the time the matter was referred.

Of this 45%, 25 offices (or 55% of the offices who needed such additional information) reported that they had encountered difficulties in attempting to obtain the information for tax administration purposes.

Among the 25 offices that reported difficulties, three offices answered the inquiry "incorrectly" in that, although they may have had difficulties in getting information from IRS, the problems they encountered were due to the fact that they desired to use the information for solely nontax purposes. (Two other offices made the same or other error, but also provided usable information regarding problems in getting additional information for tax administration purposes.)

It should be noted that the 3 responses--in the group of 22 offices that answered the question correctly--which reported problems relevant to obtaining authorization to conduct joint tax/nontax grand jury investigations are discussed separately in Section V of this report, which pertains to joint investigations.

1. Delays

Twelve offices (of the 22 which answered the question correctly) complained solely of delays in obtaining needed additional information from IRS. These problems have occurred in civil tax, criminal tax, and joint tax/nontax criminal cases. Four of the offices in this group did not provide the dates when these problems were encountered. The other offices reported that delays occurred in 1979 (7 offices), 1978 (2 offices), as well as 1977 (1 office).

It should be noted, however, that 10 of the offices which complained solely of delays specifically noted that the delay was not due to disagreements with IRS, based on Section 6103, over whether the information could be disclosed to the Government attorney. Rather, the delays were caused by administrative problems or by the inadvertent destruction of tax records at IRS. The responses of 2 offices did not explain the reasons for the delays encountered, and one office specifically cited Section 6103 as the underlying cause. (This last response relates to procedures for authorizing joint tax/nontax grand jury investigations, and is discussed in Section V of this report.)

2. Problems Relating to the Interpretation of Section 6103

Fifteen of the 22 offices that answered the inquiry correctly reported problems in obtaining additional information from IRS for tax administration purposes which appear to have been due to disagreements with IRS over whether the information sought could be disclosed under Section 6103(h) to the Government attorney. In a number of cases the disagreement was resolved and the information ultimately provided to the Government attorney. In others, IRS required that agents obtain clearance from supervisory officials before making certain disclosures. Some of the disagreements reported were never resolved.

a. Civil Tax Cases

Eleven respondents (representing 6 offices) provided details regarding problems encountered in obtaining additional information from IRS in civil tax cases. The following is a listing of the problems encountered, based solely on the details provided by the responding Government attorney.

--In a collection suit, the Department attorney needed to talk to IRS revenue officers who had obtained waivers of the statute of limitations from the taxpayer. The District Director required that the revenue officers obtain his permission before they could meet with District Counsel or the Department attorney.

--In a tort suit against an IRS agent for allegedly damaging the reputation of the plaintiff, a taxpayer under investigation by IRS, by making an unlawful disclosure of tax information, the Department attorney sought information from the agents investigating the taxpayer regarding persons who could testify as to the taxpayer's reputation. The agents were reluctant to disclose this information since they questioned whether the tort suit was a "matter involving tax administration."

--In a civil interpleader case in state court, the Department attorney requested IRS's files on the tax assessments against two taxpayers who were parties to the interpleader suits. IRS at first refused to provide them, "citing 6103." After some discussion, IRS later furnished the files to the Government attorney.

--In summons enforcement cases, especially where IRS has sought a corporation's tax pool analysis files, the Department attorney needs the assistance of an expert witness on accounting procedures. These experts derive their knowledge from experience in the IRS, and are subject to cross-examination which could reveal return information regarding unrelated taxpayers. If the Department attorney objects to such cross-examination on Section 6103 grounds, the expert's testimony might be subject to a motion to strike. This problem also arises in summons enforcement proceedings arising out of investigations of more than one taxpayer. In summons enforcement cases, agents are frequently reluctant to disclose to the Government attorney preparing for trial information regarding third-party contacts and related taxpayers.

--In the case of a John Doe summons, unusually long delays have been encountered in obtaining from IRS determinations as to the disclosability of information that the Government attorney seeks to furnish a court in order to make the showing required under 26 U.S.C. 7609(f)(2)(i.e., that "there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law").

--In refund suits there have been delays in obtaining IRS's files regarding tax years other than the years at issue in the suit, even though these files contain information relevant to the suit.

--A Department attorney had difficulty (which was not specifically described) obtaining information from IRS regarding the assessment against a principal officer of a company that, in the present case, had been assessed for payroll taxes. The information was needed to meet arguments raised by other parties to the interpleader suit that the officer's payment should be offset against the corporate liability.

--In a refund suit, the Government attorney needed FICA and FUTA information regarding a third party having a transactional relationship with the taxpayer-plaintiff. The Social Security Administration agreed to release it, but only to IRS, and there has been delay in receiving the data from IRS.

--Where a taxpayer-plaintiff was alleged to have conducted its charitable activities through a certain partnership (exact nature of case unknown), the Department attorney encountered delays in obtaining the partnership returns and the returns of the partners.

--In litigating a claim for federal income taxes in a railroad reorganization proceeding, the Department attorney attempted to obtain a General Counsel Memorandum which contained an extensive discussion of one of the legal issues involved in this case. The attorney believed the information met the "item" test in Section 6103(h)(2)(B), but IRS adopted a stricter view; the information was not provided because it contained taxpayer identifying information about another taxpayer, and could not be edited to remove this information without rendering the document unintelligible. (Two offices noted this problem with respect to obtaining office memoranda, General Counsel memoranda, or background files with respect to revenue rulings.)

--Since the passage of amended §6103, Department attorneys have not been able to obtain from IRS, in preparation for collection suits, the returns of the taxpayer's wife, children, or other persons living with the taxpayer, or the returns of the corporation that employs the taxpayer, even though it is believed that the taxpayer actually owns or controls the company.

--Since the passage of amended §6103, Department attorneys have not been able to obtain returns of other corporations in the same industry as the taxpayer-corporation, although these returns would be useful in determining whether the compensation paid by the taxpayer to its officer-shareholders was reasonable, or in determining, in cases involving the valuation of a closely held corporation for estate tax purposes, whether there had been an unreasonable allocation of income or deductions by the related taxpayer.

b. Criminal tax cases

Eleven respondents (representing 5 offices) provided details regarding problems encountered in obtaining additional information from IRS in criminal tax cases. The following is a listing of the problems encountered, based on the details provided in the responses.

--A defendant in a criminal tax case had allegedly diverted funds from a corporation for his personal use by using the name of a certain witness. This witness was under criminal tax investigation by IRS, and had provided a Q & A in which he made statements regarding his own tax liability as well as that of the defendant. Relying on the transaction test in §6103(h)(2)(C), the Department attorney, during pretrial preparation, sought the Q & A from IRS. The IRS agents claimed that the statement could be disclosed only if edited so as to relate only to the defendant's tax liability. The disagreement was eventually resolved and the entire statement was disclosed.

--A criminal tax defendant agreed to plead guilty and provide information against his co-conspirator. The court delayed sentencing to give IRS the opportunity to determine whether the defendant's information was truthful and implicated the co-conspirator. Shortly before the court-ordered sentencing hearing, the Government attorney contacted IRS as to the value of the defendant's information. The IRS agent contacted stated that the local IRS disclosure office had directed him not to disclose this information to the attorney or the court unless and until IRS referred a case against the co-conspirator to the Department of Justice for prosecution. Fortunately, the sentencing hearing was postponed, and by the time the defendant was sentenced, the co-conspirator had been indicted and IRS disclosed the information.

--During a criminal tax trial, the Government's key witness testified that the defendant had embezzled funds from him. The Government attorney then learned that IRS had commenced a criminal tax investigation of the key witness. To determine whether any Brady material existed, the Government attorney sought return information regarding the witness. There was a brief delay before IRS concluded that the information could be disclosed based on the transactional relationship between the witness and the defendant.

--During a tax grand jury investigation, IRS refused to provide the Government attorney with the returns of and investigative file regarding a nominee of the potential defendant. Although the disagreement was never resolved, the defendant ultimately pled guilty and the issue was rendered moot.

--During a criminal tax trial, the defendant's attorney submitted affidavits from third parties who claimed they had loaned the defendant money during the prosecution years. The special agent was reluctant to provide the Government attorney with the returns of the affiants. A Regional Counsel attorney subsequently authorized the agent to make the disclosure.

--During preparation for a criminal tax trial, the Government attorney sought the returns of a corporation owned and operated by the defendant, and requested that the special agent interview two individuals involved in defendant's prior bankruptcy proceeding. The agent stated that because of a recent directive from the IRS Regional Commissioner, he had to obtain prior IRS approval before he could gather the information sought by the Government attorney. The defendant ultimately pled guilty.

--In preparing for a hearing on a pretrial motion to dismiss a criminal tax indictment, the Government attorney sought information that IRS had received from an informant, which was on file with the local IRS informant claims examiner. That office claimed that the requested disclosure was impermissible. The problem was resolved by the special agent and the documents were furnished.

--In preparing for a criminal tax trial, the Government attorney encountered reluctance on the part of IRS to provide him with returns of the taxpayer for years subsequent to those at issue in the case. The returns were eventually provided.

--In preparing for a criminal tax trial (after an information had been filed), the Government attorney requested that the IRS special agent obtain repair invoices relating to the taxpayer's automobile. The agent stated that an internal policy of the Mid-Atlantic Region required him to obtain written authorization from Philadelphia Regional Counsel before he could disclose to the Department of Justice any information that IRS had acquired after the case had been referred to the Department. This respondent reports that this policy was later revoked by IRS.

--In preparing for a criminal tax trial, the Government needed the state tax returns in the possession of IRS of a partner of the defendant, in order to destablish the defendant's net worth. IRS initially refused to provide the returns on the ground that the partner was not a party to the instant proceeding. IRS later agreed that draws against the partnership' capital account was an item important for the net worth analysis. Delays were encountered while IRS located the returns.

--During a criminal tax trial, the Government attorney sought to introduce vicarious admissions by the taxpayer's CPA during a prior audit by calling the IRS revenue agent. The agent refused to meet with the Government attorney without written authorization from the District Director.

--In connection with corporate slush fund and multi-national corporate investigations, IRS did not supply the Tax Division with the identity of cases under active investigation by the Criminal Investigation Division until a particular case had actually been referred to the Tax Division, and then only where the IRS's recommendation was not against prosecution. This presented coordination problems in dealing with the Criminal Division concerning proposed plea agreements and prosecutions of multinational corporations for nontax offenses.

c. Joint tax/nontax criminal cases

As indicated above, see Section V of this report for a discussion of the responses which reported problems in obtaining additional information in the context of joint investigations.

B. Introduction of Tax Information Into Evidence in a Judicial Proceeding Involving Tax Administration

Of the 100 offices in the response pool for tax cases, 4 offices, or 4%, reported that, in a judicial proceeding involving tax administration, they were challenged in attempting to introduce tax returns, taxpayer return information, and/or return information into evidence on the ground that the proffered evidence did not meet the party, item, or transaction tests in 26 U.S.C. 6103(h)(4)(A)-(C). [This information relates to question #8 of Part III of the questionnaire.]

Response:

Actually, none of the 4 affirmative replies were responsive to the specific question asked: either the tax information in question was not being introduced into evidence, or the objection to the evidence was not based (at least not explicitly, based on the responses) on an alleged failure to meet the party, item, or transaction tests in 26 U.S.C. 6103(h)(4)(A)-(C). However, three of these affirmative responses are noted here because they provide interesting illustrations regarding the use of tax information in proceedings involving tax administration. The fourth affirmative reply to this inquiry is best treated as a response to a question in Part IV of the questionnaire regarding joint investigations, and is therefore discussed separately in Section V of this report, which pertains to joint investigations.

The first three situations reported below occurred in 1979. The final item is drawn from a response to another question in Part III of the questionnaire, which is best reported under the present heading.

--In a summons enforcement proceeding, the taxpayer-intervenor challenged the Government's introduction into evidence of taxpayer return information (information regarding dividend and interest income) from the taxpayer's returns prior to the years in issue, which were offered by the Government to show the purpose of the IRS investigation. The court admitted the evidence.

- --While a suit for injunctive relief and damages against IRS officials was on appeal, the appellant (plaintiff below) filed a motion to remand, in which he specifically referred to certain documents (apparently in the possession of the Government) which were pertinent to his case. The Government filed a memorandum in opposition to the motion for remand, and attached to its memorandum copies of the documents cited by appellant, in order to show these documents did not justify a remand, and to allow the court an opportunity to examine the documents relied upon by the appellant. The appellant then filed a motion alleging that the Government's response violated §6103--i.e., §6103(h), §7213(a)(1), and §7217. In a letter to the court, the Government relied on §6103(h)(2) and §6103(h)(4) to support the disclosure. The Court of Appeals subsequently affirmed the District Court's judgment in favor of the Government.

- --During a criminal tax trial, a defense witness's tax returns, although not introduced into evidence by the Government, were used to refresh the witness's recollection, and resulted in the witness's recantation of his prior false testimony. Specifically, the defense witness testified on direct that interest from certificates of deposit--which had been purchased by the defendant--had been earned by him, not the defendant. On cross, the Government attorney asked the witness if he reported his interest on his tax returns, and the witness replied that he had. Government counsel then showed the witness his returns for the relevant years and asked him to indicate where he had reported the interest. The witness then changed his testimony and admitted he did not report the interest. Defense counsel objected to this use of the witness's returns on the grounds that impeachment of defense witnesses through use of their tax returns could make it impossible for the defendant to obtain witnesses on his behalf. The Court overruled this objection. Government counsel later informed defense counsel on the record that he could assure future potential defense witnesses that their tax returns would not be used to impeach them, in order to remove the issue from the case in the event of appeal. The issue was not raised on appeal, and the conviction was affirmed.

- --In a summons enforcement proceeding, the Government attorney requested instructions from the IRS National Office regarding the disclosure of certain return information pertaining to third parties by the IRS special agent during his testimony. At first the IRS National Office directed the agent not to testify. The magistrate then issued an order to show cause why the agent, the IRS Deputy Commissioner, and the Government attorney should not be held in contempt for the agent's refusal to testify. IRS then reversed its position and allowed the agent to testify.

C. Pretrial Discovery Proceedings in Matters Involving Tax Administration

The third area relating to tax cases regarding which we sought information was the pretrial discovery stage of a tax case: the offices polled were asked to indicate whether, in matters involving tax administration, it was necessary to disclose tax returns, taxpayer return information, or return information of a third party or a defendant, during the course of pretrial discovery proceedings. Those offices that needed to make such disclosures were asked to describe the steps that were taken in making such disclosures, including whether a Section 6103(h)(4)(D) order had been issued by the court. [This information relates to question #9 of Part III of the questionnaire.]

Response:

Of the 100 offices in the response pool for tax cases, 33% (or 33 offices) indicated that it was necessary to disclose tax returns, taxpayer return information,* or return information of a third party or a defendant in the course of pretrial discovery proceedings. However, the responses of two offices were incorrect and were thus eliminated, making the number of correct responses 31, or 31% of the 100 offices in the response pool for tax cases.

As for the steps, if any, taken by these offices in making such disclosures, as a general matter, the procedures used tended to depend upon whether the information being disclosed was that of a defendant or a third party.

1. Where tax information regarding the defendant was disclosed to the defendant or his counsel: Four offices made the disclosures during informal discovery, relying on F.R. Crim.P. 16 and 18 U.S.C. 3500; two offices reported having obtained a standard Rule 16 discovery order; one office requires that defense counsel first submit written authorization from his client. In one case, a court ordered that one defendant's returns and return information be provided to all counsel in a 15-defendant case. A motion to seal and impound this information from other than the taxpayer and his attorney was denied.

2. Where tax information regarding a third party was sought by a defendant: Four offices made such disclosures after obtaining the consent of the third parties involved (criminal and civil cases); two offices are presently contesting defense requests for such information, and in two other cases the Government has successfully opposed such disclosure requests (civil tax cases); one office, in civil employment tax cases where the taxpayer-employer seeks the returns of employees, seeks a protective order in the event the court orders disclosure; one office reported that in a criminal tax case the court directed that the defense be provided with the tax returns of a Government witness; finally, in a summons enforcement matter, a magistrate ordered the IRS agents, over the Government's objection, to answer certain questions which pertained to return information of third parties.

3. Where the responding office did not distinguish between disclosures of tax information of a defendant and disclosures of tax information regarding third parties: Four offices reported obtaining orders under §6103(h)(4)(D)(criminal cases); six offices reported that courts have issued discovery orders under F.R. Crim.P. 16, or have directed disclosure and then issued protective orders (civil cases); seven other offices reported having made disclosures in criminal cases during informal discovery, relying on F.R. Crim. P. 16 and 18 U.S.C. 3500; one office reported that it has an "open file" policy in all criminal cases, but requires defense counsel seeking to inspect the file to sign and file with the court a stipulation that the contents will not be divulged; three offices reported that clearance from the trial attorney's supervisor is obtained before making such disclosures (civil cases); finally, one office noted that no special procedures were necessary because the tax information in question had not been obtained from IRS, but by means of grand jury and trial subpoenas.

D. Disclosures to Witnesses in Matters Involving Tax Administration

The fourth area relating to tax cases regarding which we sought information concerned disclosures to grand jury or trial witnesses. Specifically, we asked the offices polled to indicate whether, in a matter involving tax administration, they encountered any difficulties, in dealing with either grand jury or trial witnesses, concerning the disclosure of a particular individual's tax returns, taxpayer return information, or return information to another witness. Details regarding problems were requested. [This information relates to question #10 in Part III of the questionnaire.]

Response:

Of the 100 offices in the response pool for tax cases, 6 offices, or 6%, reported having difficulties concerning such disclosures to grand jury or trial witnesses.

Four of these responses were incorrect, since they pertained to other inquiries on the questionnaire. One office noted, with respect to criminal cases, that although IRS has raised theoretical objections that such disclosures are inappropriate, the Government attorney makes such disclosures under the District Court's standing discovery order. Finally, one office reported that its attorneys continually have questions about permissible disclosures in preparing witnesses in connection with criminal tax prosecutions.

E. The Use of 26 U.S.C. 6103(h)(3)(B)

The last area of inquiry on the questionnaire regarding tax cases concerned the use of 26 U.S.C. 6103(h)(3)(B). The question on the survey reads as follows: "List any matters involving tax administration in which the procedures of 26 U.S.C. 6103(h)(3)(B) were utilized to request tax returns, taxpayer return information, or return information from IRS for tax administration purposes." [Question #11 in Part III of the questionnaire. For a note regarding the reasons for including this question in the survey, see Section II(A)(2) of this report.]

Response:

Of the 100 offices in the response pool for tax cases, 9 offices (or 9%) reported that the procedures of 26 U.S.C. 6103(h)(3)(B) were utilized to request tax returns, taxpayer return information, or return information from IRS for tax administration purposes, and listed the case(s) in which this procedure had been used.

Seven of these responses were incorrect: a comparison of the case names listed with the records of this office indicates that the respondents confused the procedures of Section 6103(h)(3)(A) with Section 6103(h)(3)(B), and then listed joint tax/nontax grand jury investigations as examples.

One response has been verified as correct, and relates to tax information regarding a corporate entity. The remaining response could not be verified prior to the completion of this report--here one office stated it had utilized §6103(h)(3)(B) to obtain currency transaction reports involving banking institutions within its jurisdiction.

IV. REPORT OF THE RESULTS REGARDING THE IMPACT OF SECTION 6103 ON NONTAX CASES
(PART IV OF THE QUESTIONNAIRE)

Part IV of the questionnaire contained ten general areas of inquiry regarding the impact of Section 6103. For the most part, Part IV of the survey pertained solely to nontax cases--i.e., to administrative or judicial proceedings or investigations involving the enforcement of nontax federal criminal statutes--in connection with which the disclosure of tax returns, taxpayer return information, and/or return information under Section 6103 may have been an issue.

The ten areas covered in Part IV of the questionnaire were: 1) the utilization of procedures under §6103(i)(1); 2) the utilization of procedures under §6103(i)(2); 3) disclosures by IRS under §6103(i)(3); 4) disclosures in nontax cases of tax information during pretrial discovery; 5) disclosures of tax information to witnesses in nontax cases; 6) joint tax/nontax investigations and the utilization of procedures for obtaining authorization to conduct such inquiries; 7) the introduction of tax information into evidence in a nontax judicial proceeding; 8) the use of tax information to impeach a third-party witness in a nontax case; 9) contacts by IRS under §6103(p)(4); and 10) difficulties in obtaining state tax information for federal nontax purposes.

This section of this report discusses the results of the survey with respect to items (1) through (5) and (7) through (8) above. The results from the remaining three areas of inquiry--i.e., items (6) and (9) through (10) above--are discussed in Sections V and VI of this report.

A. The Need for Tax Information In Connection with the Investigation or Prosecution of a Nontax Criminal Matter

Of the 94 offices in the response pool for nontax cases, 79 offices, or 84%, indicated that access to tax returns, taxpayer return information, or return information in the possession of IRS would be necessary or helpful in connection with the investigation or prosecution of a nontax criminal matter. [This information relates to question #1 of Part IV of the questionnaire.]

Of the 79 offices that needed such information, 75 offices indicated that they desired access to tax returns and/or taxpayer return information, and 58 of these offices also indicated a need for return information. Four offices designated return information as the only type to which they desired access. Thus, 75 offices desired access to tax returns and/or taxpayer return information, and a total of 62 offices desired access to return information. [This information relates to question #2 of Part IV of the questionnaire.] These offices were then asked to indicate whether, after concluding there was a need for access to one or more of the three types of tax information defined in Section 6103, they then utilized the applicable procedures under Section 6103 to obtain access to the desired information.

B. Seeking Tax Returns And/or Taxpayer Return Information for Nontax Purposes Through a Court Order Under §6103(i)(1)

1. Deciding Whether to Utilize Section 6103(i)(1)

Of the 75 offices that needed tax returns or taxpayer return information, 54 offices (or 72% of the 75 offices) indicated that they actually utilized the procedures for obtaining an ex parte court order under Section 6103(i)(1). The experience of these offices in seeking court orders is set forth in greater detail in the remainder of this subsection.

Twenty-one offices out of the 75 who needed such information decided not to utilize Section 6103(i)(1). Of this group, one office did not indicate the reasons why the procedure was not utilized. Four complained that the procedure was too time-consuming; four complained that the procedure was too complex or cumbersome to justify the effort; and five cited both the complexity of the procedure and anticipated time delays as their reasons for not utilizing the procedure. Two offices stated they did not seek a court order because they did not believe they could make the requisite showing set forth in Section 6103(i)(1)(B). Four offices did not seek orders because they were able to obtain the information they needed from other sources (grand jury subpoena on target's accountant; taxpayer consent (2 offices); obtained needed information from the taxpayer's state tax returns). Finally, one office, engaged in a nontax prosecution of an IRS informant regarding whom IRS refused to disclose much information, did not seek a court order on the ground that the trial judge would not agree to an ex parte application during adversary litigation, and that if the application became public, the Government's case against the informant could be jeopardized. [This information relates to questions #3 and #5 of Part IV of the questionnaire.]

Below is a summary of the experience of the 54 offices who did seek court orders under Section 6103(i)(1). Here it should be noted that 14 of the 54 offices used the procedure only once or twice, and then ceased using it because the procedure was too cumbersome and/or too time consuming (11 offices), or because they did not believe they could make the requisite showing (5 offices). (Two offices cited both factors as their reasons for discontinuing utilization of the court order procedure.)

2. Seeking Department of Justice Authorization to Apply for a Section 6103(i)(1) Court Order

The 54 offices which utilized the procedures under Section 6103(i)(1) indicated that they submitted requests for Department of Justice authorization to apply for a total of 207 court orders. Fifteen offices each sought authorization to apply for 1 order; thirteen offices each sought authorization to apply for 2 orders; eight offices each sought authorization to apply for three orders; five offices each sought authorization to apply for 4 orders; and nine offices each sought authorization to apply for between 5-9 orders. Two offices each sought authorization to apply for 11 orders, one sought authorization to apply for 17 orders, and one office requested authorization to seek 26 orders. [This information relates to question #4(a) of Part IV of the survey.]

Of the 54 offices which requested Department of Justice authorization to apply to the court for orders under §6103(i)(1), 44 offices forwarded their requests to the Criminal Division, 5 sent their requests to the Tax Division, and 4 sent their requests to both the Tax Division and the Criminal Division. (One office did not provide this information.) [This information relates to question #4(b) of Part IV of the questionnaire.]

Fifty of the 54 offices that requested Department of Justice authorization to seek Section 6103(i)(1) orders reported that they were successful in obtaining that authorization. The remaining 4 offices provided the following information:

--One request was for authorization to apply to the court for a disclosure order relating to 77 individual taxpayers. This request was "denied" by the Department to the extent that 35 of the 77 taxpayers were eliminated from the order application.

--Two offices each reported that one of their requests had been denied by the Department, but did not supply details.

--In the fourth case, the Government attorney sought Department authorization to apply for an order permitting disclosure, in connection with a mail fraud investigation and trial, of third-party tax returns. The Department informally refused to approve the request on the ground that the Department permits attorneys to apply for court orders only to obtain the tax returns of putative defendants. The responding attorney reported that since the Postmaster General has no such policy, he obtained authorization to apply to the court for two §6103(i)(1) orders from the Postmaster General.

It should be noted that each of the four offices which reported that requests had been denied did obtain Department authorization to apply for other orders; these offices were thus retained, for statistical purposes, in the pool of offices that actually sought Section 6103(i)(1) orders from the court. See subsection 3 below. [This information relates to question #4(c) of Part IV of the questionnaire.]

The average time needed to obtain Department authorization (or to obtain a response from the Department, if the request for authorization was denied), measured from the time the Government attorney submitted his/her request, was 25.8 days in 1977, where the shortest time lapse was 2 weeks, and the longest was 2 months. In 1978, the average time was 37.2 days, where the shortest time lapse was 1 day and the longest was 6 months. In 1979-80 the average time was 24.2 days, where the shortest time lapse was one day and the longest was three months. For reported time periods which were not labeled according to the year in which the request was submitted, the average time was 31.7 days; the shortest time period in this group was 6 days and the longest was 6 months. [This information relates to question #4(d) of Part IV of the questionnaire.]

3. Applying to the Court for the Order

Of the 54 offices which applied to a court for Section 6103(i)(1) orders, one office withdrew the application after the defendant entered a guilty plea. Four offices out of the 54 which sought orders reported that their applications for orders were denied:

--one office simply reported that the court had denied an application for an order on the ground that it was neither necessary nor proper. No further details were provided.

--one office reported that the court denied the Government's *ex parte* motion for an order because trial had commenced, and the court felt that the defendant should be a party to the proceedings. Since the Government objected to any adversary proceedings, the application was withdrawn.

--one office reported that a court denied an application for an order which was presented during trial. The respondent suggested that the court was concerned about permitting such *ex parte* proceedings during the course of trial.

--one office reported that its application for an order for disclosure of two returns for use in a mail fraud and ITSP trial (involving embezzlement and diversion of charity funds for personal use) was denied on the ground that the Government had not made a sufficient showing under §6103(i)(1)(B) that there were no other available means by which the Government could obtain the information sought. The court also ruled that the Government had not sufficiently established the necessity for the material.
(Another attorney from the same office reported that one judge indicated an unwillingness to issue an order on the ground that the tax return sought would be inadmissible, on Fifth Amendment grounds, for the purpose for which the Government sought to offer it (i.e., as an admission of the defendant's receipt of fraudulently obtained income). The court permitted the Government to present the application to another judge, but reapplication became unnecessary since the defendant ultimately consented to the disclosure.)

In no case did the offices above appeal from the court's denial of their applications for ex parte orders under Section 6103(i)(1).

One office noted that, even though the court ultimately granted the Section 6103(i)(1) order, it first requested an in camera inspection of the tax return sought by the Government attorney, relying on United States v. Praetorius, 451 F. Supp. 371 (E.D.N.Y. 1978). This required the Government attorney to first obtain the return from IRS's Washington, D.C. Disclosure Office--a procedure which took about seven weeks, thus delaying the application for the order.

[This information relates to questions #4(e)-(i) of Part IV of the questionnaire.]

4. "Post-Order" Procedures: Getting the Information From IRS

Once the court order under Section 6103(i)(1) was obtained by the Government attorney, the average time period needed to obtain the tax returns and/or taxpayer return information from IRS was 67.2 days in 1977. The shortest time taken was one week, and the longest was 6 months. In 1978, the average time was 61.1 days; the shortest time taken in 1978 was 1 week, and the longest was 7 months. The average time period for 1979-80 was 41.6 days. The shortest time taken was one day, and the longest was 3 months. For reported time periods which were not labeled according to the year in which the order was obtained and the request was made from IRS, the average time was 44.5 days; the shortest time period in this group was 1 hour and the longest was 2 years. [This information relates to question #4(j) of Part IV of the questionnaire.]

C. Seeking Return Information Under the Procedures of §6103(i)(2)

1. Deciding Whether to Utilize §6103(i)(2)

As noted above, 62 offices indicated that access to return information in the possession of IRS would be necessary or helpful in connection with the investigation or prosecution of a nontax criminal matter. Of the 62 offices that needed such information, 40 offices (or 64% of the 62) indicated that they actually utilized the procedures for obtaining return information from IRS under Section 6103(i)(2). The experience of these offices in using this procedure is set forth in greater detail at the end of this subsection.

Twenty-two offices out of the 62 which needed such information decided not to utilize Section 6103(i)(2). Of this group, 2 offices did not indicate the reasons why the procedure was not utilized. Six offices complained that the procedure was too cumbersome to justify the effort; five complained that it was too time-consuming; and five others cited both the complexity of the procedure and anticipated time delays as their reasons for not utilizing the procedure. One office explained that disclosures by IRS under Section 6103(i)(2) are "worthless," because unless the entire IRS investigative file is disclosed, the Government attorney is unable to comply with Brady v. U.S., F.R. Crim. P. 16, and the Jencks Act (18 U.S.C. 3500). Another office stated that the procedure cannot be used without first explaining why the information sought is material to the nontax case--a determination which cannot be made without first knowing what information IRS has in its possession. Two other offices did not utilize Section 6103(i)(2) because they found other routes for obtaining the needed information: one utilized the procedure for obtaining authorization to conduct a joint tax/nontax grand jury investigation, and the other office obtained the return information along with tax returns by obtaining an ex parte order under Section 6103(i)(1). [This information relates to questions #6 and #8 in Part IV of the questionnaire.]

2. Problems Encountered in Utilizing the Procedures Under §6103(i)(2)

The 40 offices which indicated they had utilized the procedures under Section 6103(i)(2) submitted a total of 134 requests for return information. Thirteen offices each submitted one request; twelve offices each submitted two requests; three offices each submitted three requests; eight offices submitted 4-8 requests; and four offices each submitted 10 or more requests for return information. [This information relates to question #7(a) in Part IV of the questionnaire.]

Of the 40 offices which utilized the procedures under Section 6103(i)(2), 20 offices (or (50% of the 40) indicated they encountered problems in using the procedure. Of the 20 offices which complained of difficulties, two offices failed to provide meaningful details. Ten offices complained of delays in obtaining the information from IRS. One office stated that the procedure was too cumbersome, and another cited both the complexity of the procedure and the time it took to obtain the information. One office noted that its difficulties occurred in early 1977 (when the 1976 amendments to Section 6103 first took effect) and concerned disagreements with IRS over interpretations of Section 6103(i)(2). The remaining five offices cited the following problems, which are described below based solely on the offices' responses.

--After the Criminal Division forwarded to IRS the the Department attorney's request for disclosure under §6103(i)(2) for use in a RICO investigation, IRS refused disclosure on the ground that it would jeopardize an IRS tax investigation of the same subjects. The request was withdrawn rather than debate with IRS.

--In one case, IRS "lost" a previous authorization for disclosure under §6103(i)(2), and was "obstructionist" in its interpretation of who was authorized to receive the material, as well as to what material would be disclosed.

--An IRS agent conducting a tax investigation of an alleged heroin distributor conducted a consent search of the defendant's home, and uncovered narcotics material, scales, baggies, and traces of heroin. A few days prior to the defendant's nontax trial on charges of conspiracy to distribute heroin, the IRS agent was subpoenaed to testify regarding the narcotics paraphernalia uncovered during the search. IRS took the position that this material was "return information" and refused to allow the agent to testify unless the Government attorney first obtained disclosure under §6103(i)(2). Such a request was submitted by the Government attorney.

--In some instances, the Government attorney must wait for a reply from IRS, only to learn that there is no return information regarding the particular taxpayer, even though the FBI had informed the Government attorney that IRS had opened a tax investigation of the taxpayer. Secondly, if return information is requested regarding taxpayer X (for the nontax trial of X), and the information IRS provides also contains data regarding taxpayer Y (a target of a related nontax prosecution in the same District), IRS, prior to December, 1979, would not allow the Government attorney to use the information regarding Y in the nontax prosecution of

Y, unless another §6103(i)(2) request were submitted, this time naming Y as the taxpayer.

--Once IRS provides information under §6103(i)(2), which is usually used for a nontax grand jury investigation, IRS indirectly controls the scope of the nontax investigation due to restrictions on information-sharing between IRS and the grand jury. For example, IRS continues to use its administrative summonses in connection with its tax investigation, and subsequent access to the data obtained through the summonses under §6103(i)(2) causes problems under United States v. LaSalle National Bank and its progeny.

From the time the Criminal Division forwards a request initiated by a Government attorney for disclosure under §6103(i)(2) to IRS, the average time which lapsed before the Government attorney received the requested return information was 101.6 days in 1977, where the shortest time was 4 days and the longest was 9 months. (This figure is based on the 8 examples that were labeled by the respondents as occurring in 1977.) In 1978, the time periods ranged from 1 week to 3 months, and the average time period was 38.2 days. The average time period in 1979 was 56.2 days; the longest period was 6 months, and the shortest was three weeks. Most offices did not label the time periods by year: for reported time periods which were not labeled according to year, the average time period was 59 days; the shortest period reported in this group was 5 days, and the longest was 6 months.

D. Disclosures by IRS Under Section 6103(i)(3)

Fourteen of the 94 offices in the response pool for nontax cases, or approximately 15%, indicated knowledge of situations in which IRS had disclosed return information to their offices under the provisions of 26 U.S.C. 6103(i)(3). However, two offices responded to the question incorrectly. The remaining 12 offices reported a total of 14 occasions on which IRS had referred such information. On the average, each office received information from IRS pursuant to Section 6103(i)(3) on one occasion.

The nontax violations to which the return information related included the following: mail fraud, wire fraud, extortion, narcotics, RICO, bribery, ITSP, labor violations, bank robbery, and banking violations.

The twelve offices which responded to the inquiry correctly differed as to how extensive the return information was that they received from IRS. Eight offices characterized the scope of the information as limited, two offices characterized it as complete or extensive, and two offices did not respond to this specific inquiry.

In response to a question on the survey as to whether the information was useful to the law enforcement efforts of the recipient office, one office stated that it was too early to make this determination. Two offices stated that the information was of little or no value. The remaining nine offices characterized the information as helpful. In most cases, the information was useful to an already ongoing investigation, while in other cases the information enabled the receiving office to track down new leads or to commence nontax investigations and request returns and return information from IRS under Section 6103(i)(1)-(2).

[This information relates to question #12 of Part IV of the questionnaire.]

E. Disclosing Tax Information During Pretrial Discovery in Nontax Cases

Twenty-one of the 94 offices in the response pool for nontax cases, or 22%, indicated that situations had arisen in nontax matters in which disclosures of tax returns, taxpayer return information, and/or return information of a defendant or a third party have been necessary in the course of pretrial discovery proceedings.

One office answered the inquiry incorrectly. Of the 20 offices that answered the inquiry correctly, two did not indicate whether any special steps were taken in making these disclosures.

The steps taken by the remaining 18 offices tended, as a general matter, to depend on whether the information being disclosed was that of a defendant or a third party.

1. Where tax information regarding the defendant was disclosed to the defendant or his counsel: Three offices made the disclosures during informal discovery, relying on F.R. Crim.P. 16 and 18 U.S.C. 3500; one office obtained the taxpayer's consent.

2. Where tax information regarding a third party was sought by a defendant: Two offices obtained court orders under Rule 16 authorizing the disclosures; one office obtained the consent of the third-party taxpayer involved; and one office successfully contested such disclosure.

3. Where the responding office did not distinguish between disclosures of tax information of a defendant and disclosures of tax information regarding third parties: Six offices reported that they made the disclosures during informal pretrial discovery, relying on Rule 16 and 18 U.S.C. 3500. One office obtained the taxpayer's consent, and three offices obtained Rule 16 discovery orders from the court. One office reported that in a joint tax/nontax case, a court order under Section 6103(h)(4)(D), and a protective order limiting disclosure, were used to cover disclosures of tax information pertaining to both the tax and nontax aspects of the case.

[This information relates to question #9 of Part IV of the questionnaire.]

F. Disclosures to Witnesses in Nontax Cases

Of the 94 offices in the response pool for nontax cases, 6 offices, or approximately 6%, indicated they had encountered difficulties, in a nontax criminal matter, in making disclosures of a particular individual's tax returns, taxpayer return information, or return information to another grand jury or trial witness. [This information relates to question #10 of Part IV of the questionnaire.]

One office reported that, although the disclosure was necessary, the witness to whom the tax information related was disturbed by the disclosure. The remaining five offices outlined problems encountered in attempting to obtain, in a nontax case, the testimony of IRS agents. Although these examples are not responsive to the specific question asked in the survey, they are set forth here for informational purposes. Specifically, these offices had difficulty in obtaining clearance from IRS supervisory officials regarding the permissible scope of an agent's testimony, which was usually sought by the Government attorney for the purpose of introducing evidence regarding the defendant's nontax offenses uncovered during the course of a prior tax investigation. In some cases, this evidence consisted of admissions made by the defendant to the IRS agent. The Revenue Service's objections appear to have been based at least in part on concerns that impermissible disclosures of tax information could occur during cross-examination of the agent by defense counsel.

G. Introducing Tax Information Into Evidence in a Nontax Case

Of the 94 offices in the response pool for nontax cases, 9 offices, or approximately 9%, indicated that they attempted to introduce tax returns or taxpayer return information--obtained under Section 6103(i)(1)--into evidence in a nontax criminal proceeding, and were challenged on the ground that the proffered evidence was not "probative of a matter in issue relevant in establishing the commission of a crime or the guilt of a party," as required by Section 6103(i)(4). [This information relates to question #13 of Part IV of the questionnaire.]

Of the 9 offices which reported that they had encountered such challenges, two offices answered the inquiry incorrectly. The remaining 7 offices reported that they had encountered the following challenges to the introduction of tax information into evidence in a nontax judicial proceeding.

--In a nontax case, the court refused to admit the defendant's tax returns, offered by the Government as proof of the defendant's profit motive for dealing in smuggled merchandise, on the ground that the returns were not sufficiently probative and would raise collateral issues (the defendant was a "tax protester of sorts"). The court later reversed its ruling as to whether the returns could be used for impeachment if the defendant testified, but the defendant never took the stand.

--The court refused to admit the defendant's tax returns for the years at issue in the nontax case (offered by the Government in its case in chief to show the defendant's economic status and ownership of certain stock) on grounds of lack of relevance and probativity.

--Two offices reported they were successful in introducing, over the defendants' objections, the tax returns of the respective defendants as evidence of income from activities alleged to be in violation of nontax federal statutes.

--In a mail fraud trial, the court refused to admit the tax return of an intermediary involved in the bribery of the defendant, which was offered to show that the intermediary had such substantial assets that he would have been more likely to pass the funds on to the defendant than to have retained them for his own use. The court refused to admit the return on the ground that it might disclose to the jury the existence of a tax case that had been severed for trial.

--In another nontax case (involving violations of 18 U.S.C. 2113(a),(d), 1951, 2314, 2), the court admitted the defendant's tax returns for two years, as well as evidence that in another year the defendant failed to file a tax return, overruling the defendant's objection that the proffered evidence was irrelevant and prejudicial.

--In a prosecution for submitting a false financial statement to a bank (in which the defendant showed substantial income and other false items), the court admitted, over the defendant's general objection, the defendant's tax returns and supporting schedules, which were offered by the Government to establish the falsity of the financial statement under the theory that the returns were true and correct.

--In a bank, mail, and wire fraud case, the Government offered the corporate tax returns, showing serious business losses, in order to prove motive to defraud the bank. Defense counsel objected, arguing that the extent of the corporate losses could be shown more accurately through the company's books (which were already in evidence), since the returns did not correctly reflect the economic picture of the company in view of the fact that the preparer had taken advantage of the tax code. The matter was settled through a stipulation and the returns were not admitted.

In none of the foregoing cases did the respondents state that the probativity or relevance objections to the tax information proffered by the Government were based on the standard set forth in §6103(i)(4). Thus it is not known whether these objections were grounded on §6103, or on the Federal Rules of Evidence. However, the foregoing examples have been included here for informational purposes in view of the fact that in most of the examples lack of relevance or probativity was at least cited as the ground for objecting to the admission of the evidence.

H. Impeachment Use of Tax Information in a Nontax Case

Of the 94 offices in the response pool for nontax cases, 21 offices, or 22%, indicated that, in nontax criminal proceedings, situations have arisen in which a third party's tax returns, taxpayer return information, or return information (where this information was previously disclosed by IRS under Section 6103(i)(1)-(3)) would have been useful in an attempt to impeach that witness. [This information relates to question #14 in Part IV of the questionnaire.]

Of these 21 offices, 9 reported having encountered difficulties in attempting to use this tax information. Three offices within this group failed to explain the nature of the problem. One office simply stated that a decision was made not to use the tax information. Three offices indicated that tax information would have been useful, but that they decided not to request the information from IRS under Section 6103(i) due to concerns that it would take too long to obtain the information. One office did obtain the information from IRS under §6103(i), but complained of undue delays in procuring it. (Here it should be noted that the replies of the last four offices mentioned above are "incorrect" in that the question on the survey assumed that the Government attorney had already obtained the tax information from IRS under Section 6103(i).) Finally, one office reported that it was permitted by the court to use the defendant's tax returns for years at issue in the nontax case to impeach the defendant's testimony and show his economic status and ownership of certain stock.

V. REPORT OF THE RESULTS REGARDING THE IMPACT OF SECTION 6103 ON JOINT TAX/NONTAX CRIMINAL CASES (PARTS III AND IV OF THE QUESTIONNAIRE)

Part IV of the questionnaire sought information regarding the experience of the offices polled in the utilization of the procedures established by the Department and the Internal Revenue Service (see 26 C.F.R. 301.6103(h)(2)-1(a)(2)) for obtaining authorization to conduct a joint tax/nontax grand jury investigation. As indicated in Section II of this report, these questions were designed to test the efficiency and effectiveness of these procedures, and facilitated the identification of problem areas in obtaining or utilizing tax information in the context of joint investigations.

The information obtained from these inquiries regarding joint investigations has been divided, for purposes of this report, into two main areas. The first area concerns the utilization of existing procedures for obtaining authorization to conduct a joint tax/nontax grand jury investigation. This subsection summarizes the objective data obtained from question #11 in Part IV of the questionnaire. The second area summarizes the subjective data, provided by the responding offices in response to various questions throughout the survey, which relates to problems encountered in obtaining and utilizing tax information in the context of a joint investigation.

A. Utilizing the Procedures for Expanding an Ongoing Nontax Grand Jury Investigation to Include an Investigation of Alleged Tax Offenses

Question #11 of Part IV of the questionnaire asked the offices polled to indicate whether, after developing evidence during the course of a nontax grand jury investigation of potential tax violations, they utilized the Department's procedures for obtaining Tax Division authorization to expand the inquiry to include investigation of tax offenses, thereby having such inquiry deemed a joint investigation having tax administration purposes, in accord with 26 C.F.R. 301.6103(h)(2)-1(a)(2).

Of the 94 offices in the response pool for nontax cases, 59 offices (or 63%) indicated they had utilized these procedures. [This information relates to question #11(a) of Part IV of the questionnaire.]

In response to inquiries regarding the office to which they initially submitted their requests for Tax Division authorization, 31 of the 59 offices indicated they had forwarded their requests through the local Chief of the Criminal Investigation Division of IRS. Eight offices reported they had submitted their requests directly to the Criminal Section of the Tax Division. Seventeen offices indicated that they had forwarded requests to IRS and/or the Tax Division. Two offices stated that they had submitted their requests to the Criminal Division, and one office stated that its request was forwarded both to IRS and the Criminal Division. [This information relates to question #11(b) of Part IV of the questionnaire.]

Of the 59 offices which indicated that they utilized Department procedures for seeking Tax Division authorization to expand the ongoing nontax inquiry to include an investigation of potential tax offenses, 10 offices reported that they were unsuccessful in obtaining Tax Division authorization. Although details regarding requests that were denied were not requested on the survey, five offices provided some additional information. In one such case, IRS apparently determined that it was not appropriate to refer the matter to the Tax Division under Section 6103(h)(3)(A) with a recommendation that the Tax Division authorize a grand jury investigation of potential tax offenses, and was unwilling to lend manpower assistance to the Department attorney if the grand jury investigation were authorized. Another office reported that it was unsuccessful in obtaining Tax Division authorization of what appears to be a "project" grand jury investigation into alleged tax offenses. Two offices were unable to obtain authorization of their requests based on the information they originally supplied, and had to resubmit their requests to the Tax Division for approval. Finally, one office stated that IRS determined that the Government attorney's request was premature.

[This information relates to question #11(c) of Part IV of the questionnaire.]

From the time the request for Tax Division authorization to expand a nontax investigation to include an investigation of alleged tax offenses was submitted by the Government attorney (either through IRS channels or directly to the Department), the average time which lapsed before Tax Division authorization was received by the Government attorney was 4.5 months in 1977, where the shortest period reported was 3 months and the longest was 8 months. In 1978, the average time was 4.4 months; the shortest time lapse reported was two weeks, and the longest was one year. For 1979-80, the average time period was approximately 3.6 months (or 113 days), where the shortest time period reported was one week and the longest was 9 months. For reported time periods which were not labeled according to the year the request was submitted, the average time was approximately 3.5 months, where the shortest time reported was one week and the longest was 12 months. [This information relates to question #11(d) of Part IV of the questionnaire.]

Of the 59 offices which utilized Department procedures for obtaining authorization to expand a nontax grand jury investigation to include an investigation of potential tax violations, thereby obtaining disclosure of tax information under Section 6103(h), three offices (or approximately 5% of the 59) indicated that they encountered challenges to this disclosure on the ground that the procedure utilized is not a "referral" under Section 6103(h)(3)(A). These challenges are described below, based solely on the information provided by the responding offices.

--One office reported that the defendant's motion to suppress was premised on such a challenge, but was denied by the District Court. The Third Circuit affirmed. (U.S. v. Robert S. Bacheler, No. 78-1859 (E.D. Pa.).)

--In U.S. v. Charles Tashjian (reported by the Boston Strike Force), the defendant's pretrial motion to dismiss the indictment alleged: that the tax investigation was improperly referred because the authority was not within the power of [IRS] Deputy Regional Counsel; that the Government was not conducting a good faith tax investigation, but only sought approval to cover up prior illegal disclosures; and that the letters received by IRS did not constitute a referral under Section 6103(h)(3)(A) since no reference to Section 6103 was made. The District Court speculated that improper disclosure had occurred, despite evidence of none between IRS and FBI, but denied the defendant's motion. The case is presently on appeal.

--Finally, one office reported that in one case, the defendant's motion, grounded on IRS's alleged lack of authority to investigate the case, was denied by the court after an *ex parte* hearing.

[This information relates to question #11(e) of Part IV of the questionnaire.]

Five of the 59 offices which utilized procedures for obtaining Tax Division authorization to conduct an investigation of tax offenses as part of an ongoing related nontax investigation reported that they encountered difficulties regarding the disclosure of tax returns and/or return information obtained under Section 6103(h) to non-IRS agents who were assisting the Government attorney in the joint investigation.
One of these offices reported that they were advised [presumably by IRS] not to make disclosures of tax information to state agents participating in the federal investigation. Another office reported that IRS took the position that no disclosure was permitted to non-IRS investigative personnel. This office noted that the lack of clear guidelines in this area produces resentment on the part of investigatory agencies involved in

nontax aspects of joint investigations, and causes hesitancy on the part of IRS agents. A third office stated that it was unable to disclose tax information to a DEA agent in preparation for a Department conference on an IRS-DEA investigated RICO case. The fourth office reported that it must constantly explain to the non-IRS agents involved in joint investigations that disclosures to them of tax information is permissible under 26 C.F.R. 301.6103(h)(2)-1(a)(2). Finally, one office noted that many non-IRS federal agents believe, in view of Section 6103, that a F.R.Crim.P. 6(e) order must be issued before they can have access to tax information developed during the course of the joint investigation. [This information relates to question #11(f) of Part IV of the questionnaire.]

The final series of inquiries in question #11 of Part IV of the questionnaire related to the procedures utilized by the Government attorney when, during the course of a joint tax/nontax investigation, the tax portion of the inquiry ceases to be, in whole or in part, an objective of the investigation (i.e., prosecution on tax charges was declined as to the case as a whole or as to a particular target).

First of all, 14 of the 59 offices which utilized the joint tax/nontax investigation procedures reported that the foregoing situation has occurred. Of these 14 offices, only one office indicated that it desired to utilize the tax information originally obtained under Section 6103(h) in the continuing nontax investigation, and encountered difficulties in then utilizing Section 6103(i) procedures in order to use the tax information in the exclusively nontax portion of the investigation. This office reported that contents of certain IRS memoranda, in the context of the nontax case, were ordered to be produced by the court as Jencks Act material, but that disclosure of this information under Section 6103(i)(2)(which was sought by the Government attorney through an "emergency telephonic procedure") was not obtained until two days after the court had ordered that the material be turned over to the defendant. [This information relates to questions #11(g)-(i) of Part IV of the questionnaire.]

B. Problems Encountered in Obtaining and Utilizing Tax Information in the Context of Joint Tax/Nontax Investigations

The following information regarding difficulties encountered in obtaining and utilizing tax information in the context of joint tax/nontax investigations has been drawn from responses to various questions in Part III of the questionnaire, as well as from responses to the open-ended question in Part V of the survey. This data should be considered together with the results discussed in subsection A above.

1. Delays in Obtaining Authorization

Thirteen offices complained of delays in obtaining Tax Division authorization to expand an ongoing nontax grand jury investigation to include an investigation of alleged tax offenses. These offices noted that such delays hinder the progress of the nontax investigation and postpone the seeking of nontax indictments in order that authorization to investigate tax offenses can be obtained, and a tax investigation completed. These delays also cause disagreements with other federal investigatory agents who are anxious to complete the nontax investigation, and one office noted that while the Government attorney waits for authorization to investigate tax offenses, the nontax investigation is sometimes delayed beyond the life of the grand jury hearing the nontax matter.

Six of the 14 offices which complained of delay stated that most of the delays they have encountered have occurred within IRS. One office concluded that the multi-level review of grand jury requests within IRS is an unnecessary cause of delay, and two offices stated that delays have occurred during review by IRS Regional Counsel. Another office noted that delays within IRS have occurred because lower-level IRS officials will not formally approve a request until they receive indications that higher authorities within the agency will also approve it when submitted for their consideration. One office stated that the Tax Division is also responsible for delays that have been encountered in seeking authorization to conduct a joint tax/nontax investigation.

2. The Procedures for Obtaining Authorization

Four offices complained that the procedures developed by the Department for seeking authorization to conduct a joint tax/nontax investigation are simply too cumbersome. One office within this group noted that both the "local" and "pinnacle" approaches involve excessive red tape, and require that the Government attorney devote time better spent on the grand jury investigation to familiarizing himself with the procedures for obtaining authorization.

Three offices expressed the view that IRS Regional Counsel are reluctant to approve joint tax/nontax investigations, and that they frequently refuse to commit IRS manpower assistance to such inquiries on the ground that there is little potential for developing evidence of tax offenses.

3. Expanding the Scope of the Tax Investigation

Two offices noted that upon requesting Tax Division authorization to conduct a tax investigation of a large group of entities or individuals (as part of an ongoing related nontax grand jury inquiry), they were successful in obtaining such authorization only as to several taxpayers or transactions, with the understanding that the scope of the tax investigation could be "expanded expeditiously" to include other targets, if necessary, by the submission of additional specific requests through IRS channels. However, these two offices, as well as seven other offices, complained of delays and red tape when seeking to expand the scope of the tax inquiry to include additional tax years and/or additional targets.

One office within this group also noted that it had encountered substantial delays in attempting to "detarget" a previously named subject of the inquiry prior to proceeding to obtain that individual's cooperation through meetings with the taxpayer's attorney.

Most of the offices within this group noted that the necessity for seeking, through IRS and Tax Division channels, authority to expand the tax investigation frequently arises because of problems in identifying the individuals or entities that were included within the original authorization. One office reported that it is still awaiting a reply to its July, 1979 letter to the Tax Division requesting clarification of the reasons underlying the denial of a request to expand a tax grand jury investigation to include an additional target.

Finally, one office reported problems in attempting to obtain, once a joint tax/nontax grand jury investigation had been authorized, tax information regarding persons who were not named as subjects of the inquiry, but who had a transactional relationship with named subjects. The Government attorney was told that under a new section in "the Manual" [the manual was not identified], the Government attorney could not receive such information from IRS if he was investigating the tax liability of the transactionally related parties as well as the culpability of the named subjects without seeking authorization to expand the scope of the grand jury investigation.

4. Use of Tax Information for the Nontax as well as the Tax Aspects of the Joint Investigation

One office reported that in a joint tax/nontax investigation, IRS took the position that tax information could only be used by the Government attorney for investigating wagering tax violations, not the 18 U.S.C. 1955 violations that were also the focus of the investigation. The tax information in question had been obtained by means of a search warrant and interviews of third-party witnesses.

5. Receiving Tax Information Regarding Third Parties

One office reported that during a joint investigation, it was discovered that the target company had deposited into its account receipts from a massage parlor. To determine the taxability of these receipts, the Government attorney wanted to examine the books and records of the massage parlor, which was then under separate criminal tax investigation by the Criminal Investigation Division of IRS. However, disagreements with IRS arose as to the form the request for this information should take. The Government attorney maintained he was entitled to the information under Section 6103(h)(3)(A). After extensive discussions, IRS agreed to provide the information without requiring that the Government attorney first obtain a written request for disclosure from the Assistant Attorney General, Tax Division.

6. Other Problems

In addition to the foregoing, the following situations were reported by offices who have utilized Department procedures for obtaining Tax Division authorization to expand an ongoing related nontax grand jury investigation to include an investigation of alleged tax offenses.

--One office noted that, during a joint investigation, information developed by the grand jury investigation was supplied to IRS for the purpose of computer analysis. IRS then refused to provide the computer runs for 6 months, "despite the fact that neither the initial information nor the computer runs had anything to do with tax information."

--One Strike Force office reported that the function of initiating requests for authorization to expand ongoing nontax investigations to include an investigation of alleged tax offenses is best performed by the IRS Representative assigned to the Strike Force, who is in a position to know the case inventory of both offices. However, IRS has downgraded this position to the point where capable agents view it as a detriment to their careers, and this hinders IRS's Special Enforcement Program.
This Strike Force office concluded: "To some extent, but only to some extent, the blame can be laid upon the exclusively restrictive provisions of the Tax Reform Act. The provisions of the Act have served as a catalyst and excuse for the development of bureaucratic inertia which makes it impossible, from a practical standpoint, to develop a viable

> organized crime program with the IRS. * * * Effective organized crime enforcement...is a delicate and fragile mechanism, which is extremely vulnerable to any disruptive force. The provisions of the Tax Reform Act have come to represent just such a disruptive force--not because they are intrinsically detrimental, but because they have served as a vehicle by which the latent counterproductive influences inherent in the bureaucratic process have been able to gain sway instead of being repressed or overcome expeditiously."

VI. REPORT ON THE RESULTS REGARDING MISCELLANEOUS AREAS OF INQUIRY

The last two questions in Part IV of the questionnaire sought information regarding two additional areas of inquiry: contacts by IRS pursuant to Section 6103(p)(4), and difficulties in obtaining state tax information for use in nontax federal criminal investigations.

A. Contacts by IRS Pursuant to Section 6103(p)(4)

Of the 92 United States Attorneys' offices and Strike Force offices which responded to the survey (this figure excludes the three offices eliminated from both response pools), 82 offices reported that they had been contacted by IRS, pursuant to the provisions of Section 6103(p)(4), through which inquiries were made regarding safeguards in their offices for the maintenance and handling of returns and return information disclosed to their offices pursuant to Section 6103. (In this regard, in response to the general inquiry in Part V of the questionnaire, one office noted that "the security procedures" are unduly burdensome, requiring that the materials be kept in a safe which restricts access to the particular attorney to whom the disclosure was made--a procedure which in the view of this office suggests an unnecessary distrust of Government attorneys.) [This information relates to question #15 of Part IV of the questionnaire.]

B. Obtaining State Tax Information for Nontax Purposes

Of the 94 offices in the response pool for nontax cases, 19 offices, or 20%, reported that, in conducting a nontax criminal investigation, they had encountered difficulties in acquiring tax information from state tax agencies, as a result of either federal or state tax disclosure laws.

One office did not provide details. The problems encountered by the remaining 18 offices apparently resulted from the fact that the states in question have adopted tax disclosure statutes similar to Section 6103. The states that were cited by the responding offices in connection with difficulties in obtaining state tax information for nontax federal purposes are: California (franchise tax), Louisiana, Massachusetts (2 offices), Michigan, Missouri, New Jersey, New Mexico, New York (4 offices), Ohio, Oklahoma, Oregon, and Pennsylvania (cited by three offices). [This information relates to question #16 in Part IV of the questionnaire.]

VII. SUMMARY OF RESPONSES TO PART V OF THE QUESTIONNAIRE

This section summarizes the responses of the replying offices to the open-ended request in Part V of the questionnaire for comments and additional information regarding the impact of Section 6103 on the Department's law enforcement activities. Fifty-six of the 105 responding offices provided additional information or general comments in response to Part V of the survey.

A. Tax Cases - Section 6103(h)

The following additional information was provided by the responding offices regarding the impact of Section 6103(h) on tax cases. This information was furnished in the form of specific examples of problems encountered in the utilization of Section 6103. The following summaries are based solely upon the information provided by the responding offices, and should be considered together with the data set forth in Section III of this report. Nine offices provided additional information in Part V of the survey regarding the impact of Section 6103 on tax cases.

--Two offices noted that IRS's fear of violating Section 6103 frequently causes that agency to fail to provide to the Government attorney all the tax information needed to prepare adequately for the trial of a civil tax case.

--One office noted that in 26 U.S.C. 6672 cases, where all the parties are not before the court (the ordinary situation in the Court of Claims), a problem exists in learning what, if anything, has been collected by IRS from the other assessed persons. Although payments by these other persons have no effect on the liabilities of the parties in the suit, the Government's policy is to collect 100% only once in such cases. Thus tax information regarding collection activity with respect to assessed nonparties is very useful to the Government attorney, but difficult to obtain under Section 6103.

--One office raised the question of whether Section 6103 permits the disclosure of tax information to outside experts specially hired by the Government in civil tax litigation to handle special issues such as valuation.

--One office pointed out that, after the passage of the 1976 amendments to Section 6103, tax protesters have attempted to "trap" Government attorneys into making allegedly unlawful disclosures of tax information relating to them by submitting fictitious powers of attorney or revoking existing powers of attorney, and then challenging the attorney's disclosure to the lawyers that the attorney believed were actually representing the protesters.

--One office noted that in summons enforcement cases, IRS agents, fearful of violating Section 6103, have neglected to tell the Government attorney handling the proceeding that Section 6103(i)(1) orders had been obtained by offices seeking tax information regarding the taxpayer for nontax purposes. In other cases agents have neglected to report that, by the time of trial, they had already recommended to their superiors at IRS that a grand jury investigation of the taxpayer be conducted. In some cases the Government attorney has learned this information from opposing counsel. Information regarding both is extremely important on the issue of improper criminal purpose (see United States v. LaSalle National Bank, 437 U.S. 298 (1978)).

- --One office noted the need for better coordination with FOIA units within the Department, which make determinations whether requested information may be disclosed consistent with the restrictions of Section 6103. This office reported that, in a civil tax case, the Government attorney disclosed information which she believed was disclosable under Section 6103(h)(4). However, the attorney subsequently learned that plaintiff's counsel had made an FOIA request before instituting the tax suit, and that some of the information which the plaintiff was requesting--information which the Government attorney disclosed under §6103(h)(4)--had not been disclosed by the individual handling the FOIA request, on the ground that disclosure would violate Section 6103.

- --Two offices stated that Chief Counsel of IRS directs disclosure of wagering tax information to the Department of Justice under 26 U.S.C. 4424(b), but is very reluctant to disclose information under Section 6103(h)(2), although the language of the two statutory provisions is essentially the same.

B. Nontax Cases - Section 6103(i)

Twenty-five offices provided additional information in Part V of the survey regarding the impact of Section 6103 on nontax cases. The following summaries are based solely upon the information provided by the responding offices, and should be considered together with the data set forth in Section IV of this report.

Thirteen offices commented that the procedures for obtaining tax information under Section 6103(i) for nontax criminal purposes are simply too cumbersome and too time-consuming, especially, as some offices noted, in view of the requirements of the Speedy Trial Act. These offices offered the following proposals for improving the procedures for obtaining disclosure:

- --"Return information" should be redefined so as to include only the information which is contained on a tax return, and should not be interpreted to encompass information obtained through an investigation. (One office)

- --The distinction between "return information" and "taxpayer return information" should be abolished. (One office)

- --Authorization to seek disclosure from IRS under §6103(i)(1) and §6103(i)(2) should lie with the United States Attorney. (One office)

- --Department procedures should be amended so as to eliminate the need for the second "request letter" to IRS which accompanies the signed *ex parte* order obtained pursuant to §6103(i)(1). This office noted that there is no need to again set forth "probable cause" for obtaining the information, when the grounds justifying disclosure are already set forth in the application and the court order. (One office)

- --Procedures under §6103(i)(1) should be amended so that returns, taxpayer return information, and return information can all be obtained using the ex parte order procedure--then IRS would not be required to separate out return information when responding to a disclosure request under Section 6103(i)(1). (One office)

--The Government attorney should not be required to utilize §6103(i)(1) simply to learn that the taxpayer in question has not filed tax returns. (Two offices)

One of these offices also noted that, in nontax cases, the restrictions of Section 6103 conflict with the requirements of the Jencks Act, where the Government attorney is aware that IRS has interviewed an individual who is a Government witness in a nontax case.

Two offices reported having disagreements with IRS over which documents or information is covered by an order under §6103(i)(1), or a request under §6103(i)(2). In one case an additional order had to be obtained in order to get the remainder of the needed information from IRS. One office reported that IRS frequently requires separate orders when information is sought regarding more than one taxpayer. Another office stated that if a typing error or misspelling of a name appears in either the court order or the authorization letter from the Assistant Attorney General, Criminal Division, IRS refuses to produce the returns, even though the addresses, social security numbers, and other identifying information on the documents clearly indicate that the error is clerical and not substantive. One office reported that after the court had issued a §6103(i)(1) order, IRS stated that it did not believe that the order was adequately supported by the reasonable cause showing required in §6103(i)(1)(B), "and even went so far as to 'request' that additional 'probable cause' be added to the order and the application." One other office also had problems when it learned that IRS was not satisfied with the language of the order issued by the court.

Two offices complained of internal delays at IRS in the processing of court orders authorizing disclosure; one of these offices cited IRS's requirement that the orders be sent to its National Office in Washington, D.C. before being served on the appropriate Service Center as one cause for the delays.

One office reported that it was required to get a §6103(i)(1) order before IRS would permit an agent to testify in a civil habeas corpus proceeding (28 U.S.C. 2255), where the agent had investigated the defendant for potential criminal tax violations, and was asked to testify as to defendant-petitioner's use of pseudonyms in conducting his real estate transactions. Delays encountered in obtaining the order in turn delayed the habeas corpus proceeding.

One office reported that, after a court requested an in camera inspection of a return that was the subject of an application for a §6103(i)(1) order, the IRS disclosure officer refused to let the tax returns out of her presence when being reviewed by the judge, and forbid any discussion of the returns with the judge's law clerk--a procedure which disturbed the court.

Finally, three offices reported that they have not encountered any difficulties thus far in the utilization of Section 6103(i), and another office stated that while the procedures under §6103(i) are time-consuming, "[m]ost Assistants probably exaggerate the difficulty and amount of work that is required to secure disclosure."

C. General Comments Regarding Section 6103

Twenty-two offices provided additional information in Part V of the survey regarding the impact of Section 6103 generally on their law enforcement activities. The following summaries are based solely upon the information provided by the responding offices.

Fourteen offices expressed the view that Section 6103 has had a "chilling effect" on law enforcement, in that it makes IRS investigating agents apprehensive of making disclosures, and restricts information sharing between federal investigatory agencies. Four offices noted that the procedures under Section 6103 for obtaining needed tax information are so complex and/or time-consuming that frequently Government attorneys do not view the information as worth the effort of attempting to obtain it.

One office reported that it has had no difficulty utilizing Section 6103, and has found both IRS and the Department of Justice quite cooperative in processing its requests for tax information.

One office suggested that uniform instructions should be given to IRS agents, and made available to courts and Government attorneys, regarding the scope of permissible disclosures under Section 6103, so as to minimize possible contempt problems that might arise if a court, in either a federal or state case, should insist on the agent appearing and testifying regarding certain tax information. In this regard, this office noted that in 1979, a subpoena duces tecum was served on an IRS special agent to appear in state chancery court and bring the joint tax return of a husband and wife for use in a divorce proceeding. After much debate between IRS Regional Counsel and the attorney representing the wife involved in the divorce proceeding, the attorney was persuaded to withdraw or cancel his subpoena.

Another office complained that IRS does not take uniform positions regarding disclosure requests: in one case, this office sought tax information regarding 3 defendants from IRS, the requests being submitted at various times. One request was granted, but an identical form request as to another defendant was rejected.

One office has noted what appears to be a problem regarding what types of information come within the scope of Section 6103. Specifically, this office reported that during the course of executing search warrants for evidence of wagering tax violations, IRS agents discovered certain weapons in the possession of a convicted felon then on probation. An attempt was made to revoke the felon's probation, but an attorney in the office of IRS Regional Counsel prohibited the agents from discussing the discovery of the weapons with the United States Attorney's office on the ground that this would violate Section 6103. This attorney was also reluctant to permit the agents to discuss anything that was included in the affidavit for the search warrant. The probationer eventually pled guilty to the probation violation charge.

One office reported that IRS takes an unduly restrictive view of the information that it may disclose to the Department of Justice under Section 6103(i)(3).

One office reported the following situation: In a prosecution of X for bribery of an FBI employee, the employee testified for the Government that X had asked if she could obtain information relating to the criminal tax investigation that was being conducted regarding X by the Criminal Investigation Division of IRS. (It was generally known that IRS had issued a large number of summonses throughout the city seeking evidence of X's tax liability.) To corroborate the testimony of the employee, the prosecuting Government attorney wanted an IRS special agent to testify that X had been the subject of a criminal tax investigation during the period in question. IRS prohibited the agent from testifying on the ground that this would violate Section 6103, even though the IRS agents, when conducting witness interviews, had already disclosed to third parties that X was under investigation.

Finally, one office stated that most Assistant United States Attorneys are unfamiliar with Section 6103 and its procedures, and therefore usually do not make use of the statute to obtain tax information. This office stated that the Department of Justice can and should take steps to educate Government attorneys regarding Section 6103, either through the Attorney General's Advocacy Institute or through a separate seminar.

VIII. LIST OF SUPPORTING EXHIBITS

Exhibit #1	Questionnaire Regarding Experience of Government Attorneys with the Disclosure Provisions of 26 U.S.C. 6103 as Amended by Section 1202 of the Tax Reform Act of 1976
Exhibit #2	Letter dated November 21, 1979, from M. Carr Ferguson, Assistant Attorney General, Tax Division, and Philip B. Heymann, Assistant Attorney General, Criminal Division, forwarding the questionnaire to all United States Attorneys and Strike Force offices
Exhibit #3	Memorandum dated December 28, 1979, from M. Carr Ferguson, Assistant Attorney General, Tax Division, forwarding the questionnaire to all attorneys in the Tax Division
Exhibit #4	Letter dated January 17, 1980, from Gerald A. Feffer, Deputy Assistant Attorney General, Tax Division, requesting that United States Attorneys and Strike Force offices complete and return the questionnaire by January 31, 1980

Exhibit #1

U. S. Department of Justice

Questionnaire Regarding Experience of Government Attorneys with the Disclosure Provisions of 26 U.S.C. 6103 As Amended by Section 1202 of the Tax Reform Act of 1976

Part I

Introduction and Instructions

1. The questions asked in Parts III and IV reflect the differences in procedures for obtaining returns and return information for use in proceedings or investigations involving a tax administration purpose (governed by 26 U.S.C. 6103(h)), and proceedings or investigations involving the enforcement of nontax federal criminal laws (governed by 26 U.S.C. 6103(i)). In addition, you will note that reference is made below to "tax returns," "taxpayer return information," and/or "return information." These terms are used below as they are defined in 26 U.S.C. 6103(b)(1)-(3).

2. Please answer all the questions, even if your office has had limited experience with the statute. Where details are requested, please provide as much information as possible. For example, where appropriate please indicate when the events occurred (month and year); whether the case was civil or criminal; in criminal cases, whether tax, nontax, or joint tax and nontax violations were involved; the name of the case; whether the proceeding was a grand jury or trial; and outline the nature of any problems encountered. If feasible, the name and phone number of the Government attorney who handled the case should also be provided. If you are providing more than one example in response to a particular question, please describe each case separately, on separate sheets if necessary.

Part II

Identifying Data

Date Questionnaire Completed: ____________________

( ) United States Attorney's Office

District: ____________________

( ) Strike Force Location: ____________________

( ) Tax Division, Department of Justice, Washington, D.C.

Section: ____________

Dallas Field Office ( )

( ) Criminal Division, Department of Justice, Washington, D.C.

Section: ________________

Completed By: ____________________________
Attorney's Name

____
Title

____
FTS Tel. # Commercial Tel. #

Part III

Experience with Section 6103(h) - Matters Involving Tax Administration

The questions in this section apply to either 1) civil tax matters, 2) criminal tax matters, or 3) joint tax/nontax criminal matters. In all such cases, tax returns, taxpayer return information, and return information are disclosed to Department of Justice attorneys by IRS under the referral provisions of 26 U.S.C. 6103(h)(3)(A) and 26 U.S.C. 6103(h)(2), when the matter referred involves "tax administration," as defined in 26 U.S.C. 6103(b)(4).

1. In a matter involving tax administration, have you ever had occasion to request from IRS tax returns, taxpayer return information, or return information for tax administration purposes in addition to the information supplied by IRS at the time the matter was referred under the above procedures?

   yes ______ no ______

   If "yes," please answer #2. If "no," please continue with #8.

2. Did you encounter any difficulties in attempting to obtain this additional information from IRS?

   yes ______ no ______

   If "yes," please answer #3 through #7, and the remaining questions. If "no," please continue with #8.

3. Did the problem occur in a civil tax case? ______ Criminal tax case? ______ Joint tax/nontax criminal case? ______

4. Date when the problem arose (month and year):

5. Name of case and nature of proceeding (i.e., trial, grand jury; if a civil tax case, please describe the purpose of the proceeding, e.g., refund suit):

6. Outline, in narrative form, the details of the problem encountered:

7. Did the situation described in #6 involve an interpretation of whether the information you sought met the party, item, or transaction tests in Section 6103(h)(2)? If so, please give details.

8. In a proceeding involving tax administration, have you attempted to introduce tax returns, taxpayer return information, and/or return information into evidence and been challenged on the ground that the proffered evidence did not meet the party, item, or transaction tests in 26 U.S.C. 6103(h)(4)(A)-(C)?

   a. yes ______ no ______

      If "yes," please answer (b) through (e) below.
      If "no," please continue with #9.

   b. Did this situation arise in a civil tax case? ______
      Criminal tax case? ______
      Joint tax/nontax criminal case? ______

   c. Date when the situation arose (month and year):

d. Name of case and nature of proceeding (i.e., trial, grand jury; if a civil case, please describe the purpose of the proceeding, e.g., refund suit):

e. Outline in narrative form the details of the challenge raised, the specific nature of the proffered evidence (i.e., tax returns, taxpayer return information, or return information), the purpose of the evidence, and describe the outcome:

9. In a matter involving tax administration, have situations arisen in which disclosures of tax returns, taxpayer return information, and/or return information of a third party or a defendant have been necessary in the course of pretrial discovery proceedings?

yes ______ no ______

If "yes," please describe the steps that were taken, including whether a Section 6103(h)(4)(D) order had been issued by the court.

10. In a matter involving tax administration, have you encountered any difficulties, in dealing with either grand jury or trial witnesses, concerning the disclosure of a particular individual's tax returns, taxpayer return information, or return information to another witness?

yes ______ no ______

If "yes," please give details.

11. List any matters involving tax administration in which the procedures of 26 U.S.C. 6103(h)(3)(B) were utilized to request tax returns, taxpayer return information, or return information from IRS for tax administration purposes.

Part IV

Experience with Section 6103(i) - Matters Involving Enforcement of Nontax Federal Criminal Law

The questions in this section apply to administrative or judicial proceedings or investigations involving the enforcement of nontax federal criminal statutes, in connection with which the disclosure of tax returns and/or return information under Section 6103 may have been an issue.

1. In connection with the investigation or prosecution of a nontax criminal matter, have you ever concluded that access to tax

returns, taxpayer return information, or return information in the possession of IRS would be necessary or helpful?

yes ______ no ______

2. To what type of information did you desire access?

   ______ tax returns (if checked, please answer questions #3 through #5 below)

   ______ taxpayer return information (if checked, please answer questions #3 through #5 below)

   ______ return information (if checked, please answer questions #6 through #8 below)

3. If you desired access to tax returns or taxpayer return information, did you consider making use of the procedures in Section 6103(i)(1) for seeking an ex parte order from the District Court to obtain disclosure of this information from IRS?

   yes ______ no ______

   If "yes," please answer #4 and the remaining questions, except #5.
   If "no," please skip #4 and continue with #5, et al.

4. If you decided to utilize the procedures under Section 6103(i)(1) to obtain an ex parte order, please answer (a) through (i) below.

   a. On how many occasions did you seek Department of Justice authorization to apply to the court for such orders?

   b. To which component of the Department did you submit each request for such authorization?

   c. Were you successful in obtaining Department authorization in all cases? yes ______ no ______

      If not, how many of the requests for such authorization were denied by the Department? ______

   d. How long, from the time you submitted your request, did it take to obtain Department authorization? (Please give approximate dates.)

   e. Were all the orders which you were authorized by the Department to seek granted by the District Court?

      yes ______ no ______

      If "yes," please continue with (j) below.
      If "no," please answer (f) through (i) and the remaining questions.

   f. If not, how many were denied by the court? ______

   g. Please list any cases in which applications for orders were denied, setting forth the name of each case, the nature of each proceeding (Strike Force inquiry, grand jury investigation, trial, etc.), and the criminal violations under investigation in each matter.

   h. Summarize the grounds on which the court denied the order(s). Please provide as much detail as possible.

i. Was an appeal from the denial of the order(s) taken?

yes ______ no ______

If so, please summarize the outcome.

j. Once you obtained the court order, how long did it take to obtain the tax returns and/or taxpayer return information from IRS? (Please give approximate dates.)

5. If you decided not to utilize the procedures under Section 6103(i)(1) to obtain an ex parte order, why not?

6. If you desired access to return information, rather than tax returns or taxpayer return information, did you consider making use of the procedures in Section 6103(i)(2) for requesting the information from IRS through the Assistant Attorney General, Criminal Division?

yes ______ no ______

If "yes," please answer question #7 and the remaining questions, except #8.
If "no," please skip #7 and answer question #8, et al.

7. If you decided to utilize the procedures under Section 6103(i)(2) to obtain this information from IRS, please answer (a) through (c) below.

a. How many requests have you made under Section 6103(i)(2) for return information? ______

b. Have you encountered any difficulty in utilizing these procedures?

yes ______ no ______

If "yes," please outline the nature of the problem encountered, the date when the situation arose, the name of the case involved, the nature of the proceeding, the violations under investigation, and describe the outcome.

c. How long, from the time the Criminal Division has forwarded a written request for disclosure to IRS, has it taken to obtain the requested return information from IRS? (Please give approximate dates.)

8. If you decided not to utilize the procedures under Section 6103(i)(2) to request return information from IRS, why not?

9. In a nontax criminal matter, have situations arisen in which disclosures of tax returns, taxpayer return information, and/or return information of a third party or a defendant have been necessary in the course of pretrial discovery proceedings?

yes ______ no ______

If "yes," please describe the steps that were taken in disclosing this information.

10. In a nontax criminal matter, have you encountered any difficulties, in dealing with either grand jury or trial witnesses, concerning the disclosure of a particular individual's tax returns, taxpayer return information, or return information to another witness?

yes ______ no ______

If "yes," please give details.

11. If, during the course of a nontax grand jury investigation, evidence was developed indicating that tax violations may also have been committed, did you utilize the Department's procedures for obtaining Tax Division authorization to expand the inquiry to include investigation of tax offenses, thereby having such inquiry deemed a joint investigation having tax administration purposes, in accord with Treas. Reg. (26 C.F.R.) 301.6103(h)(2)-1(a)(2)?

a. yes ______ no ______

If "yes," please answer (b) through (i) below, and the remaining questions.
If "no," please skip (b) through (i) and continue with #12, et al.

b. Did you initially submit the request seeking Tax Division authorization--

---through IRS channels? ____ (Name IRS office to which submitted: ______________________)

---directly to the Department? ____ (Name DOJ office to which submitted: ______________________)

c. Were you successful in obtaining Tax Division authorization to expand the nontax investigation to include an investigation of tax offenses?

yes ______ no ______

d. How long did it take, from the time you submitted the request, to obtain the authorization? (Please give approximate dates.)

e. Once you obtained the authorization to expand the inquiry to include an investigation of tax violations, thereby obtaining disclosure of tax returns and/or return information under Section 6103(h), were any challenges to such disclosure made in which it was argued that such disclosure should not be permitted, because the procedure utilized is not considered a "referral" under Section 6103(h)(3)(A)?

yes ______ no ______

If "yes," please provide the name of each case in which such an issue arose, and outline the details of the challenge raised and the outcome.

f. In those matters where a joint tax/nontax investigation was approved, were difficulties encountered regarding the disclosure of tax returns and/or return information obtained under Section 6103(h) to non-IRS agents who were assisting you in the joint investigation?

yes ______ no ______

If "yes," please give details.

g. Have you had situations, during the course of such joint tax/nontax investigations, where the tax portion of such inquiry later ceased to be, in whole or in part, an objective of the investigation (i.e., prosecution on tax charges was declined as to the case as a whole or as to a particular target)?

yes ______ no ______

If "yes," please answer (h) and (i) below, and the remaining questions.
If "no," please skip (h) and (i) and continue with #12, et al.

h. In such cases, where you desired to utilize tax information originally obtained under Section 6103(h) in the continuing nontax investigation, were any difficulties encountered in then utilizing Section 6103(i) procedures providing for the usage of the tax information in the exclusively nontax portion of the investigation?

yes ______ no ______

If "yes," please outline the nature of the difficulty encountered, including how long it took, from the time you commenced utilization of the procedures under (over) Section 6103(i)(1) or 6103(i)(2), to obtain Department authorization to seek disclosure.

i. Which subsection of Section 6103(i) did you utilize?

12. Section 6103(i)(3) permits IRS to disclose return information (not tax returns or taxpayer return information) which may constitute evidence of a violation of (nontax) federal criminal law to the appropriate federal agency (which, under 26 U.S.C. 6103(b)(9) and 5 U.S.C. 551(1), includes the Department of Justice) to the extent necessary to apprise the agency of the potential violation.

a. Are you aware of any situations in which IRS has referred such information to your office?

yes ______ no ______

If "yes," please answer (b) through (e) below, and the remaining questions.
If "no," please continue with #13, et al.

b. On how many occasions, to your knowledge, has IRS disclosed such information? ______

c. Regarding what types of violations?

d. How extensive was the information that IRS disclosed?

e. Was the information useful, to your knowledge, in the law enforcement efforts of your office? (E.g., was it sufficiently detailed to be used as the basis for commencing an investigation? Was the information IRS disclosed helpful to an already ongoing investigation of those violations?)

13. In a nontax criminal proceeding, have you attempted to introduce tax returns or taxpayer return information obtained under Section 6103(i)(1) into evidence, and been challenged on the ground that the proffered evidence was not "probative of a matter in issue relevant in establishing the commission of a crime or the guilt of a party," as required by Section 6103(i)(4)?

a. yes ______ no ______

If "yes," please answer (b) through (e) below, and the remaining questions.
If "no," please skip (b) through (e) and continue with #14, et al.

b. Date when this situation arose (month and year):

c. Name of case:

d. Criminal violations under investigation:

e. Outline in narrative form the details of the challenge raised, the specific nature of the proffered evidence (i.e., tax returns or taxpayer return information), the purpose of the evidence, and describe the outcome.

14. In a nontax criminal proceeding, has a situation arisen in which a third party's tax returns, taxpayer return information, or return information (where this information was previously dis-

closed by IRS under Section 6103(i)(1)-(3)) would have been useful in an attempt to impeach that witness?

a. yes ______ no ______

If "yes," please answer (b) below and the remaining questions. If "no," please skip (b) and continue with #15 et al.

b. Did you encounter any difficulties, restrictions, or challenges in attempting to use this tax information?

yes ______ no ______

If "yes," please give details.

15. Have you been contacted by IRS, pursuant to the provisions of Section 6103(p)(4), through which inquiries were made regarding safeguards in your office for the maintenance and handling of returns and return information disclosed to you by IRS under Section 6103?

yes ______ no ______

16. In conducting a nontax criminal investigation, have you encountered any difficulties in acquiring tax information from State tax agencies, as a result of either federal or State tax disclosure law?

yes ______ no ______

If "yes," please identify the State and summarize the difficulties encountered and the outcome.

Part V

Additional Comments or Information

Please provide any additional information or comments regarding your office's experience with Section 6103. If you are citing difficulties in obtaining or using needed information, please provide as much detail as possible regarding the nature of the difficulty and the type of case in connection with which you encountered the problem.

Exhibit #2

November 21, 1979

William A. Kimbrough, Esquire
United States Attorney
Post Office Drawer E
Mobile, Alabama 36601

Re: Impact of Section 6103 on
Federal Law Enforcement Activities

Dear Mr. Kimbrough:

The disclosure provisions of 26 U.S.C. 6103, as amended by Section 1202 of the Tax Reform Act of 1976, have now been in effect for over two and a half years. During this period, Government attorneys have had to familiarize themselves with the statute as well as with the Treasury Regulations promulgated under that statute. Immediately before and after the effective date of the amendments to Section 6103 (January 1, 1977), numerous questions were raised by Government attorneys throughout the country regarding the impact of the tax information disclosure provisions on effective law enforcement. Some of those questions and concerns have no doubt been answered now that we have had the opportunity to examine the operation of the statute over time. Yet questions and unresolved issues may still remain.

In an effort to assess the Department's experience with the statute since January 1, 1977, the Tax and Criminal Divisions of the Department of Justice seek your views in documenting the effect of the disclosure provisions of Section 6103 on the law enforcement activities of your office. Attached is a questionnaire which sets forth the specific areas of our inquiry. We request that you arrange to have the questionnaire completed in duplicate by an attorney from your office who is familiar with the disclosure statute and return it to Gerald A. Feffer, Deputy Assistant Attorney General, Tax Division, who is coordinating this survey. Responses should be forwarded to Mr. Feffer in Room 4143, Main Justice Building, U.S. Department of Justice, 10th Street and Pennsylvania Avenue, N.W., Washington, D.C. 20530 by December 21, 1979. We are interested not only in the experience of those attorneys handling civil tax and criminal tax matters, but also in the comments of those responsible for joint tax/nontax criminal cases and nontax criminal matters.

We recognize that a number of factors affect the administration of the statute and its consequent impact on federal law enforcement. For example, a procedure for obtaining through judicial or administrative processes tax returns and/or return information may be viewed, based on the experience of the Government attorney, as so cumbersome or time-consuming in view of the attorney's immediate needs that he/she concludes it is inadvisable to attempt to obtain the information through that procedure. We also recognize that the manner in which the Internal Revenue Service interprets a particular provision of Section 6103 may significantly affect the impact of the statute on law enforcement. Similarly, where a court is asked, for example, to issue an order under Section 6103(i)(1), the court's interpretation of the showing that must be made by the Government in order to obtain the information sought can directly impact on the Government attorney's ability to utilize "access procedures" set forth in the statute. The attached questionnaire requests information about these and any other factors you believe merit comment. The more detail furnished regarding each of the areas of inquiry, the better we will be able to assess, on a regional and national scale, the extent to which the disclosure statute affects federal law enforcement. Please conform your responses to the specific questions set forth in the questionnaire, either by completing the form itself, or using separate sheets that conform your answers to the numbered and lettered questions on the form. After responding to the specific questions asked, any additional comments or information you believe appropriate should be included. After the completed questionnaires have been submitted to Mr. Feffer, the Department will analyze the responses in an attempt to provide an overall assessment of the impact of Section 6103 on law enforcement.

Your attention to this request is greatly appreciated.

Sincerely yours,

M Carr Ferguson

M. CARR FERGUSON
Assistant Attorney General
Tax Division

Philip Heymann

PHILIP B. HEYMANN
Assistant Attorney General
Criminal Division

Exhibit #3

All Tax Division Attorneys

DATE: December 28, 1979

M. Carr Ferguson
Assistant Attorney General
Tax Division

Impact of 26 U.S.C. 6103 on Federal Law Enforcement Activities

Attached is a questionnaire which is being distributed to all United States Attorneys' Offices, the Strike Forces, and all Tax and Criminal Division attorneys regarding the disclosure provisions of 26 U.S.C. 6103. The purpose of the questionnaire is to provide the data we need to document and assess the impact of these disclosure provisions on our law enforcement activities.

All Tax Division attorneys are requested to complete the questionnaire, and return it to Gerald A. Feffer, Deputy Assistant Attorney General, Tax Division, in Room 4143, Main Justice Building, by January 15, 1980. Each attorney should complete the questionnaire, even if he/she has had no experience with the statute, or has encountered no problems with its provisions and procedures.

Your timely cooperation with this request is appreciated.

Exhibit #4

January 17, 1980

William A. Kimbrough, Esquire
United States Attorney
Post Office Drawer E
Mobile, Alabama 36601

Dear Mr. Kimbrough:

On November 21, 1979, Assistant Attorneys General Heymann and Ferguson requested your office to respond to a questionnaire concerning your experience with 26 U.S.C. Section 6103. Since that time, Congress, the Department of Justice, and the Internal Revenue Service have initiated various efforts to streamline disclosure procedures under the statute and to consider amendments to the statute itself. Your questionnaire responses are essential to any proposals we may make to the Congress and to the Service.

We are currently tabulating the responses and would like to complete this process by mid-February. I would appreciate receiving your response no later than January 31, 1980.

Thank you for your prompt attention to this matter.

Sincerely yours,

Gerald A. Feffer
Deputy Assistant Attorney General
Tax Division

Mr. **Ferguson**. Let me make a couple of observations about the report and I am sure Mr. Heymann will have some others.

First of all, I think the results of the questionnaire have confirmed our belief that the Tax Reform Act of 1976 is responsible for the substantial rift between the Department of Justice and the Internal Revenue Service in what previously have been a rather easy flow of information both ways between the Department and the Service. The prevention of the flow of tax information except under the confined and restricted procedures set out in 6103 (h) and (i), I think, has led in some cases to mutual suspicion or mistrust as to reasons for lack of cooperation and certainly to a reduction in overall cooperation between the agencies.

I think one of the primary concerns is the uncertainty of the statutory language and procedures, vaguenesses as to just what is needed in terms of a showing under 6103(i)(1), for example, to obtain a court order. It resulted, according to the questionnaire, in at least 34 of the 94 districts never having filed an (i)(1) request for an order.

Senator **Chiles**. Thirty-four of the 94 have never filed?

Mr. **Ferguson**. That is correct. That obviously shows a failure on the part of the Department of Justice, not the Service, in educating, training of our U.S. attorneys to seek those requests. I think it also shows the kind of frustration which U.S. attorneys, not just in those districts, but I think in all districts, have felt in trying to cope with the redtape of securing information which previously had been available rather readily and easily.

PROBLEM OF ATTITUDE

Beyond this, however, I think there is a people problem. There is a problem of attitude, there is a problem of uncertainty. I think you can understand that, when employees are threatened with a new sanction in terms of personal liability for a mistake in disclosure, they are going to respond in a very conservative, careful way. Second, when the criminal sanction, which has been rarely enforced in prior years, is moved from a misdemeanor to a felony, this, again, is going to make career Government employees react very carefully before disclosing information.

This concern for one's personal welfare, to make sure one is within the law just on general principles, I think, has been misinterpreted at times by our U.S. attorneys and attorneys within the Department as an unwillingness to cooperate.

I think much could be done here, and remains to be done administratively, which I tried to suggest in my prepared statement. I do think we can also use some help in terms of a revision using Senator Nunn's pendulum metaphor: that the legislative pendulum may now swing back toward the center.

SUMMARY OF PROBLEM

Mr. **Heymann**. I would just like to say a word, if I may, Mr. Chairman. I do not know how much fault there is with the U.S. attorneys in the Department of Justice, how much fault there is with the Internal Revenue Service, how much fault there is with the statute, how much fault there is with the administrative procedures adopted under it.

There is doubtless fault in all four places. But one thing is very clear to me and to Carr and to Commissioner Kurtz. A chasm, a broad and deep chasm has developed between the Internal Revenue Service and the Federal prosecutors.

Senator CHILES. That is very clear to us, too.

Mr. HEYMANN. Carr could have gone on to give you more figures. The figures would have shown that the number of offices which used the disclosure provisions once and then stopped is large. And that the figures are probably distorted in the direction of underestimating what has happened.

The information is not flowing, the suspicions are there on both sides, the cooperation is absent and law enforcement is suffering deeply. I do not blame this on anyone.

Commissioner Kurtz appeared before 94 U.S. attorneys last week. He was, as he always is, strong, intelligent, good-humored in a situation of extreme difficulty, under onslaught. But the problem is extremely severe. I have no doubt about Commissioner Kurtz's good will or ours to solve it, but it will be a mistake to think it will be easily solved. It is deep and it has now lasted for years.

Senator SCHMITT. Mr. Chairman, if you would yield, the chasm basically has opened up since the law has gone on the books, is that right?

Mr. HEYMANN. That is correct.

Senator SCHMITT. So we know where the fundamental root cause is. Whether there are inappropriate administrative or personal actions, the thing basically started when we overreacted in law, is that not correct?

SPECIAL AGENTS SUBJECT TO PENALTIES OF LAW

Mr. HEYMANN. That is correct. I should have added what Carr said. Penalties we would never tolerate for an FBI or DEA agent are imposed on an IRS agent who makes errors under this statute. The problem has developed since the statute.

Mr. FERGUSON. These are just not theoretical. I agree with everything Philip said, as I almost always do. I would just like to give one example of the kind of sanction which every agent working for the Service must be aware of.

We just completed the defense of a special agent who was sued for a large amount of money in his personal estate. He had to stand trial before a jury. We were very concerned about it. It was a complicated and prolonged jury trial. The jury, after deliberating for some time, returned a verdict in his favor, but these suits will continue as long as Revenue agents are subjected to the threat of loss of their personal estate for a mistaken disclosure.

The disclosure in this case arose under 6103(k)(6), which allows agents to speak to other parties in the course of an investigation, giving them sufficient information to let them know what kind of questions they are asking, what information they need from the third parties.

Senator NUNN. Was that a civil suit?

Mr. FERGUSON. That was a civil suit.

Senator NUNN. Initiated by?

Mr. FERGUSON. Initiated by a taxpayer who felt that information with respect to him had been erroneously released under his reading of section 6103.

Senator CHILES. You were successful in a jury verdict?

Mr. FERGUSON. In that case we were successful in defending the agent. Next time we may not be.

USEFUL TESTIMONY

Senator CHILES. Let me say I think your testimony this morning is very frank and very helpful because I think one of the things that has been very frustrating to us is that at first the problem didn't seem to be recognized or acknowledged. At first it was a yes, the act is passed and, yes, it is a little bit cumbersome, but after all everything can be done and we are able to work this out and there are a few time delays, but basically all the information can be granted and everything will work out.

Really, I think this morning is virtually the first time that I know of that we have on the record a clear acknowledgment that all is not well, that there are tremendous problems and certainly that has to come first before we can start dealing with them.

I think many people in the Congress recognize that we went too far in the Privacy Act. Obviously, some of us are trying to do something about that. So we need to work legislatively to do something.

As you say, there are other steps that have to be taken administratively and we certainly have to have those. In that spirit of cooperation you are talking about now, and I think that is essential, first the recognition of the problem and then we are going to get together and work on it, I think Congress has to be a partner in that, too.

Part of what we have got to do is we have got to have your comments as to the legislation that is introduced. Is it the right answer? Is part of it the riqht answer? At least the comments because right now that legislation is languishing, awaiting what the administration's views are going to be. I know that takes awhile to get those views, but I think that is very essential that we get information regardless of even what your thoughts are so that we can proceed.

LEGISLATIVE PROPOSALS FROM ADMINISTRATION

If you have got a better way of doing it with some legislative proposals, then I think we need to know what those are because maybe they are better than we have.

Mr. HEYMANN. I think the administration will have legislative proposals——

Senator CHILES. Do you know when?

Mr. HEYMANN. Excuse me.

Senator CHILES. Do you know when?

Mr. HEYMANN. I would expect it would not be more than a few weeks, Senator Chiles. Would you say that?

Mr. FERGUSON. I would say so, too.

Senator SCHMITT. Couldn't we have comments on the pending legislation while you are developing those?

Mr. HEYMANN. The reasons for delay are obviously not a lack of intense interest in either the Department of Justice or the Internal Revenue Service. The reasons for delay are that there are very hard issues, such as the one Senator Chiles opened up asking about, which are being hard thought, hard debated within the administration, and it won't help you much if we reserve the hard issues in commenting on the bills that are already up, Senator Schmitt.

Senator SCHMITT. No, you certainly can tell us what you perceive of the impact of a particular proposal. You don't have to comment whether you are for or against it. Certainly your technical expertise can apply to the impact.

Mr. HEYMANN. We will try to respond quite promptly.

Senator CHILES. Senator Nunn?

Senator NUNN. One question on this line. I know Mr. Kurtz is here and will appear in a minute. We had a hearing set on the IRS, and we agreed to delay that hearing until today so both Senator Chiles and myself, Senator Schmitt, and others could ask appropriate questions. We were told then—and this hearing was set for the first week in April—that the administration would have a position within 1 week of then.

Now you are saying it is going to be weeks before we have any kind of a position. I will tell you what is going to happen. The legislative year is going to go by without us having a chance to act on this proposal. If the administration isn't ready until, say, the middle of June, you will never see a correction made this year. It is going to be difficult to make corrections this year, even if you get it up here right now.

It is a detailed subject, and I know that it is difficult, but you all have been thinking about it over in the Department of Justice for a couple of years now. I know you have a position. It is not Justice Department's position that is holding up the matter, is it?

Mr. HEYMANN. No; the Department of Justice has a position and the Internal Revenue Service has a position. In some way they have to be reconciled as an administration position.

Senator NUNN. That is why we elect the President, isn't it?

Mr. HEYMANN. That is correct.

Senator NUNN. Maybe we ought to go directly to the White House.

Mr. HEYMANN. They will work on it. When I get the decision we will move, I hope, much faster than the 3 weeks I mentioned.

Senator NUNN. I hope we can get something done this year. It is going to be awfully important we have the administration position.

Senator CHILES. The President raised the proposition in his drug message in 1977 in the summons provision and processes provision that there was a problem and that it may need to be addressed legislatively.

DISTINCTION BETWEEN CORPORATE AND PERSONAL RETURNS

Senator SCHMITT. Mr. Chairman, Mr. Heymann mentioned in passing earlier a consideration apparently that there somehow could be a distinction between corporate and personal income tax returns in the matter of what could be disclosed.

Isn't that not only probably ineffective in terms of the innovation that human beings can apply to these kinds of situations, plus it probably would have some serious constitutional questions, would it not?

Mr. HEYMANN. There are two policies that come to work, Senator Schmitt, against the law enforcement side on revelation of books and records. One policy is the fifth amendment policy. The taxpayers are, in fact, required to keep books and records and make returns, and, although the Constitution does not protect them against the use of that in law enforcement purposes, Congress seemed to say plainly in 1976 that the same type of purposes, the same type of policy the fifth amendment expresses ought to be given some weight when a person is compelled to reveal information.

On the fifth amendment argument against the IRS voluntarily on its own revealing returns, books or records, there is a solid distinction between individuals and corporations, because corporations don't have a fifth amendment privilege.

There is a second argument against requiring or authorizing the IRS to volunteer any title 18 information they pick up out of a return or books and records, and the second argument is, it is going to foul up the tax collection system. People won't be honest. That argument, I suppose, cuts equally to corporate books and records and individual books and records.

FIFTH AMENDMENT ARGUMENTS

Senator NUNN. But the fifth amendment argument has really been disgarded by the courts in several decisions. I know you still have some theoretical concerns about the principle of it, but as far as a legal matter, the fifth amendment does not pose any problem here.

Mr. HEYMANN. It is a problem of theory and principle. It is not a question of a fifth amendment law.

Senator SCHMITT. What about the due process question?

Mr. HEYMANN. I am beginning to worry that I am talking too much about a matter I have not read cases about in a long time. My honest judgment is Senator Nunn is right. There would not be a serious constitutional problem about requiring a taxpayer to file returns and still saying the IRS could and should turn over any information, any revelation of title 18 crimes that appear in those returns or in books and records, as long as there is the present provision that the taxpayer can simply write, "miscellaneous income: $257,000," and not have to explain in his return where he got it or she got it.

I think there is not a substantial constitutional problem as long as that gap is there. Do you have any thoughts, Carr?

Mr. FERGUSON. I am a bit more troubled about that, Phil. The Supreme Court has told us the objection to completing a return on fifth amendment grounds can be taken specifically with respect to a question as long as the question does not interfere with computing tax liability on a return.

The *Garner* case involved a broader objection that the Court was willing to sustain on fifth amendment grounds. However, there have been lower court decisions which have suggested that deliberate falsification of a single item on a return, even though the item was not necessary to compute tax liability, may itself be a felony.

So the line between fifth amendment protection and compelled disclosures on the return is a very thin one. I think we are still awaiting any court decision before it becomes clarified. With that asterisk, I think Phil's statement is probably right.

Mr. HEYMANN. Senator Schmitt asked a practical question, too, and it is worth noting. That is, we spend a lot of time trying to guess, whether there is much title 18 evidence of crime contained in taxpayers' books and records that would, in fact, be turned over to the IRS, or whether crooked taxpayers, criminals, narcotics dealers, organized crime people would simply censor their books and records in a way that we would not and IRS would not pick up much title 18 information. That is quite possible.

FINANCIAL INVESTIGATIVE CAPABILITY AT JUSTICE

Senator CHILES. It has been suggested that the Department of Justice develop its own financial investigative capability partially because of the problems with IRS and the statute, partially because of the complex nature of many of the major crimes that are taking place and the conspiracies perpetuating those crimes. What is your reaction to this proposal?

Mr. HEYMANN. The FBI, of course, is developing a significant accounting competence, financial investigation competence. DEA has been considerably slower, and it is perhaps more difficult for DEA to do that. We have to build in DEA and the FBI a financial investigative competence, but it will never and should never substitute completely for what the IRS can provide.

I am not only talking about the fact that we need IRS returns and IRS information; it is also that major investigations frequently do involve and should involve both title 18 and title 26 counts. Crooks don't generally, or at least regularly, pay their full taxes on corruptly or violently earned income. We ought to work together; we ought to be able to rely on joint grand juries with IRS help for the financial side of joint grand jury investigations.

Beyond that, you have to think a little bit about where will excellent talent develop in terms of financial investigations? Can the Federal Government ever develop it to the same degree, deliver the same career prospects in DEA or Customs or Alcohol, Tobacco and Firearms or even the FBI? Will the accounting talent, financial investigative talent ever be rewarded as much?

I guess the answer to that is no. Although we should be building in FBI and DEA, perhaps in Customs and elsewhere, the IRS is always going to have an important role here.

Senator SCHMITT. Thank you, Mr. Chairman. I think that that last statement is a very important part of our record and just underlines the need to develop the legal framework, as well as the administrative framework in which these various agencies can apply their best talents and integrated strategy to fighting drug trafficking that exists.

We are not doing it now. We are basically unsuccessful, although there is excellent work being done by individuals and by groups. When you look at the total volume, you might as well not be doing it for all the impact we are making.

Senator CHILES. We thank you very much for your testimony. As I say, I think what you have told us today is the most helpful news we have here to date that at least we have a problem that is recognized and we are beginning to come to grips with how to deal with it.

Thank you.

DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

COMMISSIONER WELCOMED

Senator CHILES. Next the committee would like to call Commissioner Kurtz, the Commissioner of IRS.

Mr. Kurtz, we are delighted to have you with us this morning to present testimony on criminal enforcement activities at the IRS, as well as the overall budget request for the agency for fiscal year 1981.

Before the committee hears your testimony regarding the budget proposals, we would like to continue our discussion of the criminal enforcement provisions. You might introduce—I see you have Mr. Wolfe—introduce your staff.

INTRODUCTION OF ASSOCIATES

Mr. KURTZ. Singleton Wolfe, Assistant to the Deputy Commissioner; N. Jerold Cohen, Chief Counsel; Joseph Kump, Fiscal Management Officer; Bill Williams, Deputy Commissioner; and Arthur Kallen, Director, Office of Budget and Program Analysis, Department of the Treasury.

Mr. Chairman, I have a prepared statement on the budget in general. I take it you would like to discuss this issue.

Senator CHILES. First.

CRIMINAL ENFORCEMENT PROVISIONS

Mr. KURTZ. I have no prepared statement specifically on this issue. Let me say by and large I would associate myself with the remarks of Messrs. Ferguson and Heymann as to where we are in this issue. We have been working very closely and intensively with the Justice Department to identify where the problems are and to develop, to the extent we can, administrative solutions. I know Justice is doing the same thing on their side to try to reduce the delays which everybody has encountered in the past, and to intensify the training of our agents to identify information for disclosure. On Justice's side, they are addressing the question of further training of U.S. attorneys and others to use effectively the provisions of existing law. In that way, both of us feel that we can make significant progress under existing law.

At the same time, we have been addressing the points raised in the legislation that has been introduced and trying to come to an administration position and to recommend legislation which would eliminate some of the problems that have been identified in the administration of

6103. At the same time it is necessary to preserve what we believe are legitimate privacy interests of taxpayers. That is moving along very quickly.

On the administrative side, most of the changes that we will be making are in progress now and we expect them to be implemented very shortly. On the legislative side, I think we are very close to having a legislative draft bill.

STREAMLINING THE DISCLOSURE PROCESS

Senator CHILES. We understand that you appointed your task force last December to examine the administrative and procedural and policy changes to streamline the flow of information among the various agencies.

Could you tell us more specifically what procedural and administrative changes that you are going to make to streamline the information disclosure process?

Mr. KURTZ. Yes, there are several changes. First, we have a new procedure which will streamline the administrative review of grand jury requests and put tight time deadlines at each level with the objective of completing our approval within 25 to 30 working days of the request.

Another was the addition of subjects to the grand jury investigations. Until now, adding subjects has required the same procedures as for initiating grand juries in the first place. This will be substantially streamlined so that while the grand jury is in progress, if an additional target of grand jury is identified, that person can be added to be covered in the grand jury proceeding quickly.

Second, in furnishing information under section 6103(i) (1), (2), or (3), we agree with GAO's suggestion that approval be decentralized to our field offices with a post review by the national office. Approval of these requests is essentially noncentralized.

Third, where the disclosure request involves physically securing a return from one of our Service Centers or Federal Records Centers, we are changing our procedures so that these requests will be treated as high priority requests with deadlines for securing the return.

We are confident that with these new procedures and with high level management attention, which I am sure the new procedures will get, we will be responding expeditiously. We know on Justice's side they are going through the same process of attempting to minimize their procedural delays.

I also agree with Mr. Ferguson that we will establish a joint IRS–DOJ task force to meet on a continuing basis to address these problems, to handle them promptly when they are detected and to resolve them at the highest levels immediately.

We are also putting in a so-called hot line. That is a central place in the national office where either our own people or Department of Justice attorneys can call, get the problem raised to the appropriate level, and get a result quickly.

SPECIAL ENFORCEMENT PROGRAM RESOURCES

Senator CHILES. Looking at the resources allocated toward the special enforcement program, the Criminal Enforcement Division has requested $141.3 million and 4,380 positions. Of that, only 26 million or 19 percent of the total resources is to be devoted to special enforcement programs. Based on the information that we have been able to get from the Criminal Enforcement Division, of that, 26 million or 19 percent of the total resources, only approximately 19 percent of the subtotal or $8.5 million and 185 positions are going to be devoted to drug enforcement efforts.

Mr. KURTZ. I have some questions with the numbers which I will ask Mr. Wolfe to check.

Mr. WOLFE. In fiscal year 1981, we estimate that we will devote between 28 and 29 percent of our Criminal Investigation Division resources to the special enforcement program—SEP—at a cost of about $40 million. This includes about 820 special agent average positions and about 428 management, administrative support, and clerical support average positions—a total commitment of about 1,248 average positions. Of these resources estimated for all special enforcement program activities, we estimate that between 24 and 25 percent will be used in narcotics investigations, around $10 million. Based on our historical program experience, this would be about 304 average positions of which 200 are special agents. As a point of comparison we used a total of 251 average positions in fiscal year 1979 in the narcotics program of which 163 were special agent average positions. We expect to use about 275 total average positions in fiscal year 1980 of which 180 will be special agent average positions. We are firmly committed to spend the resources needed to investigate the narcotics cases we are able to identify or that are supplied to us by DEA. If these narcotics cases in fiscal year 1981 exceed our estimates which are based on past experience, we will spend the resources to investigate these cases.

Senator CHILES. I would like to know if our numbers are off, but the question is, in view of the significant subterranean economy problem related to unreported drug income, do you believe that IRS is devoting adequate resources to the drug trafficking problem?

Mr. KURTZ. The percentage that you have mentioned is not in any way a ceiling or a quota, nor does it represent the maximum effort that we are willing to make in this area. What it represents is an estimate based on prior experience of the resources that will be consumed in this area.

Senator CHILES. Doesn't that become a self-fulfilling prophecy? If that is the amount of money and the amount of positions that are based on past history.

Mr. KURTZ. We do not have——

Senator CHILES. The last question I asked you, my information is you have got $8.5 million and 185 positions devoted to drug enforcement efforts.

Mr. KURTZ. That is an estimate. It is a number of special agent staff years which we estimate will be devoted based on the history of working all of the leads that DEA has furnished us and an estimate of what resources that will consume. These are not specific people who are designated to do only narcotics work.

This is the time of special agents that winds up in the course of a year being devoted to that work. Let me ask Mr. Wolfe to respond to the numbers.

Mr. WOLFE. Mr. Chairman, we put out a program letter every year to our field officials and they are directed to examine any high level narcotics case, irrespective of the cost. In our planning, we do have to make estimates and the only way we estimate is on prior history. We know previously how many staff years we used in this.

As you know, we get from DEA all class 1 violators. In addition, we develop some of our own. We have also requested from DEA that they give us all of their class 2 violators.

We will then investigate all of those class 2 violators to determine the tax liability. So, if the number of cases that we uncover or are given to us by DEA exceeds the resources we have allocated, we will spend the resources——

Senator CHILES. You have just said what I think is a magic term: "We uncover." What kind of request do you have in here for your development of intelligence to attempt to uncover drug violations?

We know at one time there was a substantial capability within IRS in regard to intelligence. Now we are told that that has virtually been dismantled and there is very little capability.

Mr. WOLFE. Mr. Chairman, we spend about 25 percent of the time in the special enforcement program in the narcotics area. Also, our agreement with DEA provides they will do the undercover work and we will not get involved in any case in which they are proceeding.

Senator CHILES. Again, Mr. Wolfe, the answer seems to be if you are spending about 25 percent of the funds that are allocated. Is that 25 percent of the total funds for special enforcement programs or is that the 25 percent of the 8.5 million for drugs.

Mr. CLANCY. Mr. Chairman, you asked, perhaps a broader question. How much time do we spend in case development information gathering, in intelligence gathering within the narcotics area, and in the total enforcement activities of Criminal Investigation Division.

In regard to the narcotics time itself, last year we spent 163 special agent staff years against narcotic traffickers. Approximately one-fourth of that 163 staff years was devoted to intelligence gathering and case development. Does that answer the question?

Senator CHILES. Is it 163 or 185 staff years for narcotics?

Mr. CLANCY. We realized 163 special agent staff years last fiscal year, fiscal 1979; 180 special agent staff years is an estimate that will probably be spent in fiscal 1980. For each of the past 4 years, I believe, we have increased time applied to the narcotics project. My answer is also limited to special agent staff years, not examination, not support positions; the actual investigative staff years.

NARCOTICS PROGRAM RESOURCES

Senator NUNN. The Internal Revenue Service was asked in the December 1979 hearing of PSI whether or not the money Congress appropriated for IRS narcotics programs is being used in that program. As I understand, the answer supplied by IRS in writing, which we have before us, is that Congress appropriated approximately $20 million and 779 positions for IRS and narcotics programs through 1974.

IRS stated it began to reduce its resources in the narcotics program after 1974 and resources IRS received for its narcotics program were redirected to IRS's general tax enforcement efforts in tax fraud and examination. IRS further stated it could not now track this $20 million over 780 positions.

Is this analysis correct? Is my interpretation of this analysis correct?

Mr. KURTZ. My understanding is after that appropriation, that was 1974, I believe, there was no segregation beyond that year of funds specifically to be directed to the narcotics program.

Senator NUNN. Did you, in fact, carry it out in that year?

Mr. KURTZ. 1974? Yes, I am told.

Senator NUNN. What would be the sense behind the 1 year effort in the narcotics area? Does that make any sense from anybody's perspective? Congress does not necessarily make sense on everything. Frequently, we don't. I can't understand setting up those positions for 1 year.

Mr. KURTZ. Senator Nunn, in an appropriation of that kind—they are not separate positions; people are not hired specifically for that purpose. It is a question of the programs in which special agents and others who are on board devote their time during the course of a year.

They may in 1 year devote more time to the narcotics program and in another year devote more time to a different aspect of criminal enforcement activities. It is not a question of hiring people and laying them off again.

Senator NUNN. Did you obtain congressional approval to redirect the resources that were appropriated for the narcotics program?

Mr. KURTZ. This is Joseph Kump, our fiscal officer.

Mr. KUMP. Senator, as we testified, we did in fact spend the resources that were appropriated that year. The Internal Revenue Service has four operating appropriations, all of which have a life of just 1 year. None of the authorities or funds appropriated carry forward except by subsequent review by the current Commissioner, the Deputy Secretary of Treasury, the OMB and the Congress in the annual budget review and appropriations process.

ANNUAL APPROPRIATION REVIEW

Senator NUNN. What you are saying is, if Congress wants you to carry out a particular program beyond 1 year, not only does it have to increase earmarked funds for that year and tell you what it wants you to do, but it has to do that in the baseline budget every year, is that right?

Mr. KUMP. It seems to me, sir, the administration, in its next year's budget proposal, needs to review what it wants to propose to the Congress for funding and in turn the Congress needs to, again, review that earlier decision inasmuch as the appropriations have only 1 year authority.

Senator NUNN. What you are saying is the baseline appropriations of the IRS need to be thoroughly reviewed every year then, because if Congress gives you direction that adds on 1 year, after that 1 year you are through with that. You are going to merge into your general program and ignore the congressional request unless specifically renewed? Is that right? That is an interesting theory.

Maybe that is the way IRS always operates. I don't think that is the normal budget practice as interpreted by the Congress.

Senator CHILES. That is not the standard appropriation practice. The standard appropriation practice, if it goes in the base and stays in the base, it is in there for the purpose for which it was put.

Senator NUNN. If you put additional positions in for the Internal Revenue Service, we have to watch those carefully, on a year-by-year basis, because as soon as 1 year is over, you are going to put them where you darn well please, regardless of the intent of Congress.

Mr. KUMP. We will propose, on an incremental basis in the annual budget process, adjustments to the base; yes, sir. Included in this budget submitted here, there are specific reductions proposed to the base, given the present climate. This has been basically our situation since fiscal year 1976, which has been to take a very hard look at the use of base resources in the annual budget process.

RESOURCE ADEQUACY

Senator CHILES. Let me just try to put my question one more time that I started off with. You have got a Subterranean Economy Report which you have told us in our earlier hearings you think includes low estimates and we certainly think it is low, and in that report, we estimate $20 billion of untaxed profits from drug operations and IRS is devoting $8.5 million and 185 positions or man years, to attempt to collect the taxes on $20 billion.

Now I think that effort is inadequate. And regardless of how many class 1 violators you are looking at or class 2 violators you are looking at, or what the law says, the law charges IRS to go out and collect the revenue and if it is $20 billion from illegal drug profits that is not being taxed it seems to me that if you ask Congress for only 185 positions and $8.5 million to go get that $20 billion, that is a little short.

Mr. KURTZ. The number is actually a little bit more than that. The current plan for fiscal year 1980 is 349 positions because there are positions other than criminal investigators, such as examinations, collection, legal services, and other support positions.

Senator CHILES. Those are overhead positions.

Mr. KURTZ. Some overhead positions. There are revenue agent, revenue officer, attorney positions also. The 349 is the total for fiscal year 1980. For fiscal year 1981 our budget request asks for 379 positions in the narcotics area.

As I say, they are estimates, not ceilings. They are not intended to be ceilings.

Senator CHILES. They are pretty close to what you spent last year. Let's get away from these estimates. Last year you had 163 positions and so I assume that is under $8 million that would cost to fund those positions. Again, I am not satisfied that that is sufficient resources allocated to go look for what was $20 billion in 1978.

Mr. KURTZ. Senator Chiles, let me say, it is a very hard decision in allocating scarce resources. We have in total about 2,800 special agent staff years. With those 2,800, which is our total special agent capability, we have the responsibility of 95 million tax returns.

We allocate roughly 70 percent to the general program, 30 percent to the special enforcement program, special enforcement being those taxpayers who are narcotics, strike force, organized crime cases. I cannot sit here and tell you with any degree of certainty whether that is ideal, whether it should be 40 or 25. They are very difficult decisions of judgment that have to be made, but there are a wide variety of tax crimes.

Senator CHILES. Let me ask you the question this way: You had 927 positions for narcotics in 1974?

Mr. KURTZ. Yes.

Senator CHILES. You have 185 that you are talking about now.

Mr. KURTZ. They are not the comparable figures. We estimate that we will realize 349 total average positions in fiscal year 1980 and 379 in fiscal year 1981.

CHANGE IN NARCOTICS WORKLOAD

Mr. WOLFE. Senator Chiles, I guess I am one of the few people here who was around when that happened. Those were the days in which we were doing street cases, as well as middle and upper echelon narcotics traffickers and financiers. Actually, we were investigating many street cases. We got court cases against us that probably influenced the Congress to pass the Tax Reform Act of 1976.

Frankly, we ran out of work. I saw some of the work we did. As I testified a few minutes ago, today we will work any of the upper echelon cases that come to our attention or that we can find.

IRS ASSISTANCE NEEDED BY U.S. ATTORNEYS

Senator CHILES. Obviously, what we hear from every strike force and from every U.S. attorney is the crying need they have for the financial expertise of the IRS agents to work with them in their cases.

Do you want to know something you can do? That is something you can do. You can provide them that financial expertise. I hear that from every U.S. attorney I speak to in my State.

Mr. KURTZ. Senator Chiles, there is no reluctance at all on the part of the Internal Revenue Service to be involved in high level financial crimes and narcotics. We view that as a very important function that we have.

As you point out, there are large amounts of money involved. Compliance among those people is very low, to say the least. When we have been requested by U.S. attorneys to join a grand jury investigation, a strike force, a CENTAC unit, there has been no reluctance on our part to furnish whatever personnel are required to work those tax cases.

We just heard testimony a few minutes ago that over a third of U.S.

attorneys have never asked for tax return information. I think there are very, very few examples of IRS turning down requests for assistance and those are based solely on a decision made within the Internal Revenue Service that there is no potential tax crime.

Beyond that, we furnish whatever resources are needed.

NARCOTICS STRATEGY

Senator CHILES. Mr. Kurtz, tell me what is your strategy at IRS to tax this $20 billion that is out there in illicit revenues? In my State, it was estimated in 1978 at $7 billion. That is in the economy of my State that is untaxed. It increases the cost of a house by more than $2,000 in Dade County because of pure drug inflation. Its corrupting influence is there on our local law enforcement, public officials, courts, everywhere you turn.

We have the "cocaine cowboys" killing themselves and innocent people out on the street every day, and the highest murder rate we ever had. We have drugs landing there every day. What do I tell those people—that the strategy is at the IRS? Is it to wait until somebody sends us them a class 1 violator? Can I tell them we have 193 people this year that are going to try to go out there and handle the problem in the whole country?

Mr. CLANCY. In the Jacksonville district for the first 6 months of this year, 40 percent of our CID resources were applied in the special enforcement program. A substantial part of that is in the narcotics area.

One of the questions to a prior witness dealt with coordination with Customs. IRS has, I think, effective coordination with Customs in a number of ways. One way, specifically in Florida, involves working with the Assistant Secretary of Treasury for Enforcement as a full partner and participant in a money flow project dealing with the investigation of the flow of currency as evidenced by the currency transaction reports, both domestic and foreign, that are required to be filed either with the Internal Revenue Service or with Customs, depending on the type of currency transaction.

That investigation is being coordinated with not only the Criminal Division of the Department of Justice but also the Tax Division of the Department of Justice. So there is a significant number of activities the Revenue Service is involved in, in the area that you are describing.

OTHER AREAS OF CONCERN

Senator CHILES. Senator Laxalt has been sitting here very, very patiently waiting for an opportunity to ask some questions on several specific subjects, I think, in regard to taxpayer information. Senator, I want to apologize to you for not putting you on sooner. I understand that you have got 20 minutes or so of questions to ask.

We were trying to finish up this subject matter, of course, before we could turn it over to you. I know you are on a tighter time schedule.

Senator LAXALT. May I make a suggestion, Mr. Chairman?

Senator CHILES. Yes.

Senator LAXALT. First of all, I understand the delay in that we are obviously dealing with very important matters when it comes to narcotics violations. I do have several matters I want to inquire about. I would ask unanimous consent, as quickly as possible. Perhaps we can meet again so I have an opportunity to explore these various areas with the people from IRS if that is satisfactory.

Senator CHILES. We will probably have to schedule some other time. We will get with Mr. Kurtz and see what the earliest convenient time is.

Senator LAXALT. I would appreciate that.

Senator SCHMITT. I think that is important, Mr. Chairman. Your and Senator Nunn's questioning today is also extremely important. It has become sort of a theme of our hearings this year in a variety of different areas. I don't think we have lost anything at all by doing it. I think we have gained a great deal. However, I do think there are going to be other issues to explore with Mr. Kurtz.

Senator CHILES. This has been a function of the committee traditionally for oversight in this area. We certainly will accommodate you in that regard.

Senator LAXALT. I thank the chairman and Senator Schmitt.

Senator CHILES. Senator Nunn.

ADMINISTRATION POSITION ON LEGISLATION

Senator NUNN. As you know, our Permanent Subcommittee on Investigations, of which Senator Chiles is a member, and other committees are interested in this whole question we are in now, the Tax Reform Act and so forth.

We had hearings scheduled in early April. We postponed that hearing at the request of the Internal Revenue Service because we understood the administration would have a position to present within about a week. Now it has been about 3 weeks and there still isn't any position by the administration.

Can you tell me, No. 1, whether Internal Revenue Service has a clear position on the legislation that has been introduced and, No. 2, whether the Administration has a position at this point in time and, if not, when do you expect an administration position?

Mr. KURTZ. Senator Nunn, it was my understanding after frequent and intense meetings that a position had been worked out within the administration that was acceptable to all. I was told just toward the end of last week that a new issue had been raised that has to be addressed. As soon as we resolve that issue, we will be ready to go forward with a legislative proposal.

Senator NUNN. Do you have any idea of the timeframe for that?

Mr. KURTZ. I would hope very quickly.

Senator NUNN. Next week or two?

Mr. KURTZ. I would hope so; yes.

Senator NUNN. Do you mean on everything but one issue, both Justice and IRS now have come to an agreement?

Mr. KURTZ. That is right. There are a few little details but on the essential issues, yes, that is correct.

Senator NUNN. On this one issue you do not have agreement.

Mr. KURTZ. It just came up.

Senator NUNN. What is that issue?

Mr. KURTZ. Corporate tax returns.

Senator NUNN. Whether or not they are to be distinguished from individual tax returns?

Mr. KURTZ. Yes.

Senator CHILES. Along the lines of which Mr. Heymann was talking about this morning?

Mr. KURTZ. Yes.

Senator NUNN. So we can look forward to receiving some official administration position within a week or two?

Mr. KURTZ. It is a question of predicting when the parties who appear to have a disagreement will come into agreement. It is just the one issue. The rest of it, I think, has been satisfactorily resolved.

Senator CHILES. Do you anticipate that is going to be like a position we are going to get or are we going to get an administration bill?

Mr. KURTZ. A bill.

Senator CHILES. Will that be one bill or are we talking about more than one.

Mr. KURTZ. IRC section 6103 and the summons provision.

Senator NUNN. Will you include comments at that time? Will you be prepared to comment on the difference between that proposal and proposal that Senator Chiles and myself and others have introduced so we can get your comments on that legislation?

Mr. KURTZ. Yes.

Senator NUNN. Are we going to have several fundamental differences based on your present analysis? Are we going to have 1, 2, 10, 15? How far apart are we going to be in terms of trying to come to agreement?

Mr. KURTZ. It depends how broadly or narrowly we define different. There will be a number of places that will be a little different. I think there are one or two fundamental differences between the bills. When I say fundamental, I mean it goes to that what I would consider substantial matters.

Senator NUNN. I would certainly hope we can get that position early because the ideal way to handle this is through the normal legislative process with appropriate hearings before the Finance Committee and the Ways and Means Committee on the House side, and working through the committee process.

In the absence of having time to do that, though, it would be my intention to bring this up on the floor as amendments to other legislation. Certainly that is not the preferable way, but I think this is the most important law enforcement problem that faces the country now.

I think it is an area in which if we can take action, we would have done more to improve law enforcement than any other single legislative proposal that is now pending or will be pending in the future. I don't have to tell you the degree of frustration there is in the law enforcement community on these issues.

Mr. KURTZ. We are fully aware of that, sir.

Senator NUNN. Including your own people?

Mr. KURTZ. Yes.

DISCLOSURE TO CONGRESS

Senator NUNN. Mr. Kurtz, just one question. We have gone back and forth in this area about the 22 or 23 cases that involve major narcotics interdiction. We got letters and met with your capable counsel. It is almost ludicrous that the Congress can't find out what it is the Internal Revenue Service is doing in terms of prosecuting major class 2 violators.

It also borders on the absurdity that the Justice Department itself, the principal law enforcement agency, cannot get information from the Internal Revenue Service to determine whether the Internal Revenue Service, indeed, is making substantial number of cases against class 1 and class 2 violators.

Do you have any recommendations along this line?

Mr. KURTZ. Congress can find out this information. The Senate Finance Committee, the House Ways and Means Committee, and the Joint Committee on Taxation have access to all this information in executive session. It is available to those committees of Congress upon written request and it is available to any committee of Congress subject to specific IRC section 6103 requirements.

Senator NUNN. Where is the distinction made between committees? The Finance Committee can get this information?

Mr. KURTZ. Yes, in executive session. The Finance Committee can get it under section 6103 upon written request.

Senator NUNN. But our committee, Government Operations Committee, cannot get it.

Mr. KURTZ. Under 6103, you cannot get it without a resolution of the Senate. With a resolution of the Senate you can get it.

Senator CHILES. What about the Appropriation Committee in its oversight?

Mr. KURTZ. It is not included in 6103 for automatic disclosure; it requires a Senate resolution.

Senator NUNN. I am like those Federal district attorneys out there, I have more important things to do than to run around trying to get a Senate resolution passed to get permission from the Internal Revenue Service. If that is the only way we can get it, we have to change the law. It is an absurdity when a committee with oversight over your Department cannot get that information. It is ridiculous.

I can understand the confidentiality part of it. We could handle it confidentially. I think that is ridiculous. Of course, that is a provision of the law, not your fault.

Mr. KURTZ. In the earlier testimony, you heard the penalties for violation were severe, indeed.

Senator CHILES. Listening to the testimony of Mr. Heymann and his statement that the problems are there, I really haven't exactly heard that note from your testimony, Mr. Kurtz. You had a meeting with the U.S. attorneys. I think you gathered from them that they don't think all is well.

Mr. KURTZ. I didn't mean to imply, Mr. Chairman, that all is well. I meant to associate myself with his remarks that there are substantial problems there. I would have to be closing my eyes to the facts of life to say there are not. We recognize that there are problems. There are problems in the way the provisions of 6103 have been administered by us, and there are problems with the way they have been administered by the Department of Justice.

I testified about that before other committees and they are problems to which we are addressing ourselves. There are also problems under the law to which we are addressing ourselves.

I believe changes are in order, both administrative and legislative, and we are working on those.

At the same time, let me say, I do feel very strongly that there are real privacy interests that need to be protected and a balance has to be struck between those interests and effective law enforcement.

SPECIAL AGENT OVERTIME

Senator NUNN. Mr. Chairman, I have one more line of questioning. Mr. Kurtz, at PSI hearings last November, IRS was asked to provide figures to reflect overtime pay for special agents to determine whether special agents were hampered in their activities to investigate major criminals.

The figures provided show that IRS's premium pay went from a high of $4,950,000 in 1974 to a low of $1,885,345 in 1977. Today, IRS pays about $2,547,328 in premium pay, or about one-half of what it did in 1974, and that doesn't discount the inflationary increases in pay.

Everybody would like to save money in salaries, but it is my understanding that people in law enforcement areas simply can't do the job unless they work some overtime. By not having overtime you are really gutting law enforcement efforts.

Why is there less overtime now than in 1974?

Mr. KURTZ. I think it is due to tighter management controls over overtime. On review, we found the use of overtime was excessive and paid to people who did not need the overtime to carry out their job.

Senator NUNN. Most of this is in the special agent area rather than audit agent?

Mr. KURTZ. Yes.

Senator NUNN. Haven't the number of special agents increased from 2,519 in 1974 to 2,871 in 1980?

Mr. KURTZ. Yes.

Senator NUNN. Let me ask Mr. Clancy this question: Don't agents who work narcotics and organized crime need overtime flexibility to meet with informants, surveillance——

Mr. CLANCY. Yes, sir.

Senator NUNN. Do you agree law enforcement efforts are impeded when overtime efforts are cut?

Mr. CLANCY. Law enforcement efforts would be impeded in certain types of investigations if agents were not allowed to work the overtime and, obviously, be reimbursed for it.

Senator NUNN. This is your personal opinion, do you believe the cut in overtime by IRS has impeded effective law enforcement efforts?

Mr. CLANCY. In certain areas, I believe it is true. I believe it has been corrected. The testimony before your committee previously, I believe dealt with the southeast region, specifically, with the Jacksonville district.

My understanding is that the more restrictive controls in Jacksonville district have been rescinded. The chief's memorandum to his agents on the use of overtime has been rescinded. He is being directed to follow the IRS guidelines which were developed, by the way, in concert with the other Treasury bureaus. That is probably the single reason why there was a dramatic decline in premium pay between 1974 and 1975.

We found we were probably not using premium pay consistent with the intent of Congress. We were using it as a means to buy extra staff, to a certain degree.

Senator NUNN. You are saying the southeast region is being restricted too much?

Mr. CLANCY. Yes, sir.

Senator NUNN. Have you arrived at the proper balance between efficient management and saving money and the flexibility needed in law enforcement? Do you think you have arrived at that?

Mr. CLANCY. We think we have since the southeast was brought into the guidelines.

Senator NUNN. When were they brought into the guidelines?

Mr. CLANCY. Last month.

Senator NUNN. Since the hearings we had?

Mr. CLANCY. Yes, sir.

Senator NUNN. We would like to be kept up on this if you would furnish for the record any kind of statistics to update this.

Thank you, Mr. Chairman.

Mr. CLANCY. On April 11, 1980, the chief, Criminal Investigation Division, Jacksonville district rescinded his memorandum of April 3, 1979. We are satisifed that Jacksonville is now following the same guidelines as our other offices. For the record, shown below, is the actual utilization of premium pay by our special agents for 1974 through 1979 and our estimates for 1980 and 1981.

[The information follows:]

Fiscal year:	*Premium pay*
1974	$4,950,000
1975	3,780,000
1976	2,171,000
1977	2,187,000
1978	3,036,000
1979	3,337,000
1980	3,230,000
1981	3,458,000

PREPARED STATEMENT

Senator CHILES. Mr. Kurtz, let's go on now to the IRS budget request. IRS has requested $2,359,111,000 for fiscal year 1981; $99,186,000 for the 1980 supplemental. We will insert your full statement in the record.

[The statement follows:]

STATEMENT OF JEROME KURTZ

Mr. Chairman and members of the Committee, I am pleased to be here today to present the proposed budget for Fiscal Year 1981 and a supplemental request for fiscal year 1980 for the Internal Revenue Service. First, I would like to introduce my associates: Arthur D. Kallen, Director of the Treasury Department's Budget and Program Analysis Office; and from the Service: Deputy Commissioner, William E. Williams; Assistant to the Deputy Commissioner, Singleton Wolfe; and Assistant Commissioners Joseph Davis for Resources Management; Robert Rebein for Inspection; Donald Porter for Data Services; and Allen Winborne for Employee Plans and Exempt Organizations. Since we testified before you last year, we have three newly appointed Assistant Commissioners and a new Chief Counsel. I would like to introduce them and, with your permission, submit their biographical statements for the record: Gerald G. Portney for Technical; Russell E. Dyke for Planning and Research; Eddie Heironimus for Taxpayer Service and Returns Processing; and N. Jerold Cohen, the Service's Chief Counsel. Our Fiscal Management Officer, Joseph Kump, is also with us today.

Summary of the Revised Budget Request

Our revised budget request for fiscal year 1981 provides for average employment of 89,027 and some $2.359 billion. This is an increase of 843 average positions from the appropriated level for fiscal year 1980. In dollars, the fiscal year 1981 request is $67.6 million more than the requested level for fiscal year 1980. These numbers reflect the President's March 31, 1980 reductions.

I would like to point out that this proposed budget will reduce in 1981 the Service's currently authorized operating levels--after taking into account cost increases and taxpayer population growth for fiscal year 1981. Audit coverage will continue to slip; the unpaid accounts backlog will continue to increase; and we have not budgeted for growth in the number of taxpayers in the taxpayer service program. Additional resources are requested only in programs where strengthened tax enforcement is particularly essential and workload pressures are especially great. We view these investments as vitally necessary to assure continued confidence in our tax administration system.

Increases proposed in the Service's budget will allow the Information Returns Program (IRP) to match a substantial number of wage, interest and dividend statements (received from employers, corporations, and financial institutions) with tax returns and to follow through on apparent underreporting of income or nonfiling of tax returns. Resources are also included to enable the Collection program to begin to cope with growing backlogs of delinquent tax accounts where tax liability has already been established but remains unpaid. Resources are provided to allow the Service to continue its multi-year program to replace aging and obsolete ADP equipment used to process returns and maintain tax accounts. The Service's request provides resources needed to cope with increased workload in several programs, most notably in the number of returns filed, which are expected to increase by 2.1 million primary returns or approximately 1.6%. The balance of the request covers estimated increased costs of operations in 1981.

Within currently authorized funding, the Service has established, at an executive level, a Taxpayer Ombudsman to improve and expedite resolution of taxpayer concerns and complaints and to participate in the review and development of policies, procedures, and tax forms in the role of taxpayer advocate.

The proposed budget also reflects a goal of achieving substantial savings through increased productivity, amounting to some 1.4% of current authorized staff (1,250 average positions and $18.4 million). While it is especially difficult to achieve productivity savings during periods of budget austerity with workload growth and constant changes in tax legislation, the Service is committed to plan and manage aggressively for productivity.

In 1977 the concept of Management Generated Savings was introduced to encourage line managers to undertake productivity initiatives. During fiscal year 1979 some $3.6 million in productivity savings were realized through this system. Similarily, in 1979, the Service established a Productivity Enhancement Reserve of $600,000 with an objective to fund studies and other projects, often multi-year in scope, where attractive productivity opportunities are identified. Together, we see these initiatives as a self-sustaining source of productivity savings which will also serve to expand cost consciousness at all levels in the IRS.

I would like now to discuss in more detail our program plans and related resource needs for fiscal year 1981.

SALARIES AND EXPENSES APPROPRIATION

Executive Direction

The Executive Direction function in the Salaries and Expense Appropriation includes my office, the EEO, Taxpayer Ombudsman and Public Affairs offices, the Assistant Commissioners and the Chief Counsel and their immediate staffs and the Planning and Research function.

Our proposed budget for this activity is 358 average positions and $16.5 million, a net increase of eleven average positions. This increase results from a proposed shift of current staffing from the Taxpayer Service Program to establish the office of the Taxpayer Ombudsman in my immediate office to strengthen and enhance the existing Problem Resolution Program by giving it greater emphasis and visibility as well as executive-level direction.

An increase of $200,000 is also requested to keep pace with the rising costs of research and development studies.

Other activities within the Executive Direction activity continue essentially at current authorized levels.

Internal Audit and Security

The proposed budget for Internal Audit and Security reflects a decrease of 14 average positions. Through increased productivity (the use of nationally and regionally coordinated audits and greater use of paraprofessional employees) we believe we can maintain a high level of integrity and efficiency in administering the tax laws in fiscal year 1981 with reduced staff.

Management Services

This activity develops and recommends policy and administers the budget and accounting system, training, logistics, personnel, labor relations, physical and data security, and centralized district office support services.

This request totals 785 average positions and $26.5 million, an increase of 56 average positions. Included are 37 average positions funded under the Service's Management Generated Savings Program from non-staff cost savings achieved in fiscal years 1979 and 1980 by Management Services. It also includes 11 average positions transferred from other Service functions as a result of organizational realignments. Increases of 8 average positions are required: (1) to support the Tax Forms Distribution Program for taxpayer population growth; and (2) to provide logistics support for site preparation, procurements, and equipment installation for the Service's Equipment Replacement Program (ERP).

Legal Services

Legal Services is requesting a total of 1,749 average positions and $56.6 million in FY 1981, an increase of 55 average positions and $3.5 million.

A continued uncontrollable increase in cases in litigation -- up an average of 10% annually over the past five years -- combined with the need to maintain other legal services, at least near present levels, will necessitate additions to the legal staff in FY 1981. We hope this increase will enable Legal Services to maintain program levels.

Included in the proposed increase is $745,000 to develop and test an integrated Counsel/Appeals automated case tracking system. This system will replace most of the existing manual system and an automated system designed in the 1960's. Some of the potential benefits are: (1) increased case control; (2) better allocation of resources; and (3) providing current data to facilitate preventive management instead of reactive management. Implementation of this system is expected to produce future-year savings in average positions that would be available for other areas within the Legal Services activity or to reduce the Service's budget request.

Technical Rulings and Services

The total program level of 733 average positions and $25.2 million for the Technical activity will allow us to maintain, in FY 1981, the planned levels of service for FY 1980. No staffing increases are being requested.

TAXPAYER SERVICE AND RETURNS PROCESSING APPROPRIATION

Data Processing Operations

This activity provides funds for processing tax returns, issuing refunds, notices of tax due, and accounting for revenues. It also includes the cost of maintaining the Service's automated data processing systems. Our requested FY 1981 resource level for Data Processing Operations totals 28,267 average positions and $582.7 million, a net decrease of 788 average positions over the FY 1980 authorized levels and an increase of $2.4 million. The net decrease in average positions is the result of several adjustments:

- We have a productivity goal of 548 average positions beyond those specific program savings noted below as an offset against requested increases.
- The establishment of the Collection Branch in the service centers to centralize collection work formerly performed by Returns Processing and Accounting involves a transfer of 823 average positions to the Investigations and Collection Appropriation.
- We estimate that approximately 139.2 million primary returns will be filed in FY 1981, an increase of 2.1 million over FY 1980. We require an estimated 494 additional average positions for FY 1981 to process these additional returns and to process an estimated increase of 1.5 million refunds and an increased number of Federal Tax Deposits in our ten service centers.
- Our request also includes 286 additional average positions for the Information Returns Program (IRP). This program matches wage, interest and dividend statements with data reported on tax returns, thereby systematically identifying unreported income and non-filers. The Service has been authorized resources to match all usable individual information returns received on magnetic media plus 15 percent of paper documents. With the advent of Combined Annual Wage Reporting (CAWR) in FY 1980, we hope to match in excess of 80% of individual information returns received with individual tax returns. We will apply 224 of the 286 additional average positions to process apparent underreporter cases created as a result of additional information from the CAWR legislation. The remaining 62 average positions are necessary to reimburse the Bureau of Public Debt for Series E and EE Bond interest data.

- Although Combined Annual Wage Reporting (CAWR) reconciliation resource requirements have increased by 261 average positions, we anticipate implementing systemic improvements, saving 340 average positions, which will more than offset these requirements and result in net estimated productivity savings of 79 average positions from this effort.
- Additional resource requirements have been offset by several other items, totaling a net increase of 4 average positions. Also, because eligibility requirements for Earned Income Credit can now be determined from information on Forms 1040 and 1040A, we anticipate a need for less correspondence with taxpayers regarding their eligibility. This will result in an additional estimated savings of 122 average positions.

Another part of Data Processing Operations is the Data Services Program. Data Services will continue to maintain all ADP systems and implement systems modifications as required to maintain an effective system of processing tax returns and supporting documents. No additional staffing resources have been requested for Data Services. Essential systems workload will be maintained in order to sustain current ADP operations while our effort is directed toward developing new systems designs, hardware specifications, and software packages for the Equipment Replacement Program.

ADP Equipment Replacement Program

The Service is on schedule with the planned replacement of its aging ADP hardware and software systems through long term acquisitions of systems of modern technology. These systems are planned to have the capacity to handle future growth in workloads into the late 1990's.

During the next seven years, we will be requesting acquisition funds for ADP equipment, facilities support, developmental personnel, and training support. The initial phase of this plan, the Service Center Equipment Replacement phase, will require additional budget authority of some $5 million in FY 1981 to reimburse GSA for site alterations in the first five service centers and to fund the architectural design and GSA supervision for the second group of five centers.

Mr. Chairman, with your permission, we would like to provide for the record our current estimates of cost and timetables for implementation of the Equipment Replacement Program over the next seven years.

Statistical Reporting

The FY 1981 requested level of 676 average positions will essentially maintain the current Statistical Reporting Program at current year levels.

Taxpayer Service

The proposal for the Taxpayer Service activity totals 5,198 average positions and $214.4 million, down by 61 average positions from the authorized levels for FY 1980. At this level we will assist somewhat fewer taxpayers than in FY 1981.

Our request includes 4 additional average positions in the Tax Forms Distribution Program to handle the growth in the number of tax forms issued, and 16 average positions for the Information Returns Program (IRP) to answer taxpayer questions concerning notices generated by the IRP. These increases have been offset by the transfer of positions to the Salaries and Expenses Appropriation to establish the Office of the Taxpayer Ombudsman and to reflect anticipated savings resulting from consolidating the correspondence workload for general tax issues under the tax forms component of Technical Rulings and Services.

EXAMINATIONS AND APPEALS APPROPRIATION

Examination

I would like now to comment briefly on our Examination program. Even in times of restrictive budgets a sufficient audit presence is essential to the continued success of our voluntary compliance system. Examination of returns is one of the primary means by which noncompliance is corrected and public confidence in firm and fair tax administration is maintained.

Our requested resources for the Examinations program in FY 1981 total 28,347 average positions and $791.7 million, a net decrease of 65 average positions and an increase of $15.4 million. With these requested resources, however, audit coverage will continue to slip somewhat from current levels. We have not finalized our audit plan as yet for the March 31, 1980 revised budget. However, we believe the coverage level will decrease from 2.07% estimated in the President's January, 1980 budget request to approximately 2.03% in this revised budget request.

Included in this request are 233 average positions and $4.5 million necessary to follow up on leads of apparent underreporting of income identified in the Service's Information Returns Program (IRP).

Appeals

The Service proposes a program level for the Appeals activity in FY 1981 of 1,945 average positions and $61.3 million, which reduces the number of appeals officers and auditors currently authorized by 10 average positions. The Appeals activity offers taxpayers an independent administrative review of contested tax assessments by providing taxpayers an opportunity for resolving disputes with the least possible delay. The Appeals activity encourages compliance with the tax laws by maintaining public confidence in the Service's effort to administer tax laws fairly and impartially with as little inconvenience to taxpayers as possible.

In FY 1979 the Service moved from a two-tiered appeals function, consisting of Examination District Conference staffs and Regional Appellate offices, to a single level of appeal. We are in our second year under the new one level of appeals and have realized productivity savings of some 190 average positions, which are being utilized in our Examination function.

INVESTIGATIONS AND COLLECTION APPROPRIATION

Tax Fraud Investigations

The resources requested for the Tax Fraud Investigations activity in FY 1981 total 4,380 average positions and $141.3 million, including 2,877 special agents, the same number currently authorized. This activity enforces the criminal provisions of the Internal Revenue laws which, when warranted, includes recommending prosecutions. With the requested resources, the Service will maintain its efforts in the special enforcement areas of organized crime, narcotics traffickers, and wagering, with appropriate coverage of abusive tax shelters, corporate fraud, illegal tax protestors, questionable refund schemes, willful underreporting of tax and other general fraud investigation areas.

Collection

In the Collection Program, which has the responsibility for collecting unpaid taxes and securing unfiled returns, the proposed budget totals 13,348 average positions and $328.4 million, an increase of 1,740 average positions and $33.8 million over the authorized level for FY 1980. The proposed increase includes 823 average positions being transferred from Returns Processing and Accounting to establish Collection Branches in the service centers. In the Accounts Receivable Program, we expect to close during FY 1981 approximately 2.1 million unpaid accounts, leaving a substantial backlog of 1.5 to 1.9 million accounts in inventory. (The estimates of backlog have been updated subsequent to the preparation of the budget.) Total revenue collected should reach about $6.1 billion, up $400 million from FY 1980. To accomplish this, we have requested an increase of 465 average positions to collect unpaid accounts. This additional effort is necessary to allow us to begin to deal with some of the substantial growth in unpaid accounts that has occurred in recent years. On July 1, 1976, the inventory of accounts receivable was 614,000. By January 1, 1980, the inventory had more than doubled to 1,250,000 unpaid accounts.

The Delinquent Returns Investigations Program identifies taxpayers who have not complied with their filing requirements. An additional 454 average positions are needed in this program to follow up on leads of apparent nonfiling of tax returns identified from the Service's Information Returns Program (IRP). An estimated $950 million will be assessed as a result of the Delinquent Returns Investigation Program.

The Collection Activity also includes the Returns Compliance Programs (some 267 average positions). These programs identify and secure returns from those who have never filed tax returns, but who are liable to file. Once these delinquent taxpayers are identified and their returns secured, delinquency checks attempt to assure that required returns continue to be filed. Assessments from these efforts in FY 1981 are estimated at $24 million.

Employee Plans and Exempt Organizations

The budget request for Employee Plans and Exempt Organizations assumes that determination letter requests related to employee plans will decline in FY 1981 due to the completion of most of the requalifying pension plans generated by the Employee Retirement Income Security Act of 1974 (ERISA). However, letters requesting determination on exempt organization status are expected to increase. Requested staffing for Employee Plans and Exempt Organizations totals 2,200, a reduction of 71 average positions from the authorized level for FY 1980.

Summary

In closing, I would point out again that the budget we are requesting for the Service in fiscal year 1981 is a bare maintenance request -- a budget which will not allow the Service to maintain 1980 planned levels of services in the face of growing demands but which we hope is sufficient to preserve public confidence in our system of voluntary compliance.

Within the resources requested, we have carefully established priorities which stress the mix of programs we believe will do the most to continue present levels of voluntary compliance with the tax laws.

I believe the public's perception of IRS as an efficient organization that can deal effectively with taxpayers' questions, complete the audits it has begun, and collect taxes that have been assessed are crucial elements in maintaining voluntary compliance. Our voluntary compliance system is one in which we can be proud, but it can not be taken for granted. We need your support in obtaining these necessary resources.

I would like to note for the Committee that our budget request provides for an approximate 10% increase in printing costs of tax packages; however, data available subsequent to preparing the budget and subsequent to our testimony before the House on this subject shows that our printing costs for the tax packages this year were up about 20%. Also, the resources are not included to provide for:

- implementing the Crude Oil Windfall Profits Tax Act of 1980;
- implementing proposed legislation to withhold taxes on dividends and interest; and
- administering local taxes in the Northern Marianas as contemplated in P.L. 95-348 as amended by P.L. 96-205

FY 1980 Supplementals

We are also here to testify in support of our fiscal year 1980 supplemental request of $1 million in the "Payment Where Energy Credit Exceeds Liability for Tax" appropriation. While our requested language change to authorize a current year indefinite appropriation will resolve this in fiscal year 1981, this increase is needed in the current year to avoid delay and hardship to taxpayers who are due refunds from this account.

Additionally, our request includes a revised fiscal year 1980 supplemental need of $99.2 million to help cover the increased costs of the Governmentwide pay raise of 7 percent which was effective October 7, 1979. These costs have been incurred since that time at the rate of some $4 million each biweekly pay period.

Mr. Chairman, my colleagues and I will be happy to answer questions that you or the Committee may have.

BIOGRAPHY OF RUSSELL E. DYKE

Russell E. Dyke was appointed Assistant Commissioner (Planning and Research) on September 23, 1979. The Planning and Research organization consists of four divisions in the National Office: Research and Operations Analysis Division, Legislative Analysis Division, Internal Management Documents Division and Statistics Division.

Mr. Dyke started with the IRS as a Management Analysis Officer in Washington, D.C. After holding a series of increasingly responsible positions there, he was chosen in 1973 for the IRS Executive Selection and Development Program, which offers specialized training to employees who demonstrate executive potential.

In June, 1976, he was named Director, Returns Processing and Accounting Division, Office of the Assistant Commissioner (TX).

Mr. Dyke is a native of Washington, D.C. He earned a BCS and a MCS degree in accounting from Benjamin Franklin University, Washington, D.C.

He is married to Ruth Carolyn Floyd of Galveston, Texas. They have two children.

BIOGRAPHY OF M. EDDIE HEIRONIMUS

M. Eddie Heironimus was made Deputy Assistant Commissioner, Taxpayer Service and Returns Processing on January 28, 1979. Mr. Heironimus, 46, received a B.A. degree in mathematics from Miami University in Oxford, Ohio in 1955.

A career government official, Mr. Heironimus began his IRS employment in 1960 as a management analyst. Since that time he has held a series of increasingly responsible positions. Mr. Heironimus served as Director of the National Computer Center from 1971-1974, and Director of the Andover Service Center from 1974 until his appointment as Deputy Assistant Commissioner in 1979. He has also attended the IRS Executive Selection and Development Program.

A native of Springfield, Ohio, Mr. Heironimus is married to the former Susan Di Gloria and resides in Reston, Virginia.

BIOGRAPHY OF N. JEROLD COHEN

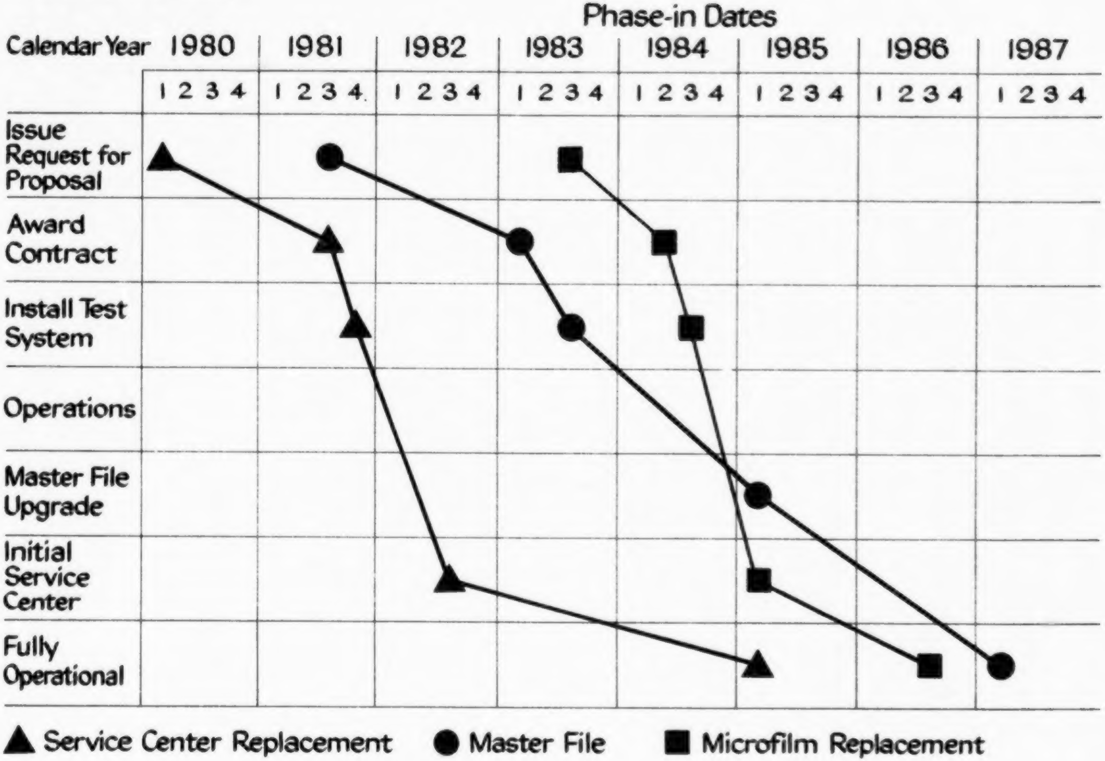
N. Jerold Cohen took the oath of Office as Assistant General Counsel of the Treasury Department and Chief Counsel for the Internal Revenue Service on November 13, 1979.

Mr. Cohen was born on June 13, 1935 in Pine Bluff, Arkansas. He received a Bachelor of Business Administration (B.B.A.) degree in 1957 from Tulane University and a Bachelor of Laws (LL.B) degree magna cum laude in 1961 from Harvard Law School, and he is a member of the Georgia, New York, and District of Columbia Bars, as well as a member of the Georgia, Atlanta, and American Bar Associations.

From 1961 to 1965, Mr. Cohen practiced law with the New York City law firm of Cleary, Gottlieb, Steen and Hamilton; and, from 1965 to 1979 he was associated with the law firm of Sutherland, Asbill and Brennan in Atlanta, Georgia, and Washington, D.C., and he was a partner in that firm from 1968 to 1979.

Also, from 1967 to 1976, Mr. Cohen was an adjunct professor of law at Emory University School of Law in Atlanta, Georgia. He was Chairman of the Atlanta Community Relations Commission, and he is a former member of the Board of Directors of the American Civil Liberties Union, and past President of the Georgia ACLU. Mr. Cohen resides in the District of Columbia.

TIMETABLE


Phase-in Dates
Calendar Year
1980
1981
1982
1983
1984
1985
1986
1987
1 2 3 4
Issue Request for Proposal
Award Contract
Install Test System
Operations
Master File Upgrade
Initial Service Center
Fully Operational
▲ Service Center Replacement
● Master File
■ Microfilm Replacement

EQUIPMENT REPLACEMENT PROGRAM BUDGET AUTHORITY

(In Constant FY 80 $Millions)

	FY80	FY81	FY82	FY83	FY84	FY85	FY86	FY87	TOTAL
Staff Years	188	190	315	490	470	258	102	26	2039
Salary Dollars	5.6	5.6	8.7	13.5	12.9	7.1	2.8	.7	56.9
Equipment Dollars	—	—	8.3	36.4	14.5	19.7	25.3	22.5	126.7 **
Facilities Dollars	.2	5.2*	7.6*	4.0	6.0	5.4	3.6	2.0	34.0*
Total ERP	5.8	10.8*	24.6*	53.9	33.4	32.2	31.7	25.2	217.6

* These totals have been increased by $1.1 million since the Treasury Submission because the Cincinnati Annex is delayed. Facilities costs include increased recurring expenses (i.e., SLUC and Utilities) attributable to ERP. Travel costs are included.

** Equipment costs have been increased to reflect the requirements identified during RFP development, and to allow for use of COBOL.

SEALED BID SALE NOTICE

Senator CHILES. You could provide us with a brief highlight of that statement——

Senator NUNN. Mr. Chairman, before Mr. Clancy leaves, I have one other question, if I could, to ask before he gets away. This is something that just came to my attention. Perhaps it hasn't come to yours.

This is a sealed bid sale notice by the Internal Revenue Service and they are selling a good bit of property which obviously had been seized in some kind of tax deficiency proceeding.

I just want to read you lot No. 3. This is a sale by the Internal Revenue Service and I quote from your bid notice, which I will give you a copy of:

"Lot No. 3

"Smoking merchandise and paraphernalia, including: approximately 700 pipes, water pipes, bongs, and pipe parts; 1 lot cigarette paper, 1 lot clips, cigarette cases, pouches, containers, air spray, and miscellaneous smoking accessories."

The administration, on the one hand, is pushing model paraphernalia laws in the States, but here we have a public sale by the Internal Revenue Service of obviously narcotics paraphernalia.

I would hope this would not be in accordance with any kind of directive from the Internal Revenue Service. It would be an exception. Could you take a look at that and furnish us with you comments. The Tax Reform Act, as far as I know, wouldn't cover that.

[CLERK'S NOTE.—A copy of the sealed bid sale follows:]

Notice Of

Sealed Bid Sale

Under authority contained in section 6331 of the Internal Revenue Code, the property described below has been seized for nonpayment of internal revenue taxes due from

White Gold Trading Co., dba Cosmik Debris, 293 S. Sheridan Blvd., Lakewood, CO 80226

The property will be sold at public auction in accordance with the provisions of sections 6335 of the Internal Revenue Code, and related regulations

Date Bids will be Opened Feb. 15 19 80 **Time Bids will be Opened** 9:00 A.M. ~~P.M.~~

Place of Sale 293 S. Sheridan Blvd., Lakewood, CO 80215

Title Offered: Only the right, title, and interest of White Gold Trading Co., dba Cosmik Debris in and to the property will be offered for sale. If requested, the Internal Revenue Service will furnish information about possible encumbrances, that may be useful in determining the value of the interest being sold. (See back of this form for further details.)

Description of Property

Lot No. 1

Fixtures and office equipment including: 1 Sharp electronic cash register; 7 wooden display cases: 1 lot shelving; 1 Unitrex adding machine; 1 lot desks and chairs; 1 3-M "149 Copier;" 1 safe (S/N 597544) R 3786: 1 lot misc. business equipment and supplies.

Lot No. 2

General novelty merchandise, including: approx. 35 T-shirts and jackets; approx. 180 pieces of jewelry; 1 lot misc. posters, books, magazines, cards, games, plaques and incense.

Lot No. 3

Smoking merchandise and paraphernalia, including: approx. 700 pipes, water pipes, bongs, and pipe parts; 1 lot cigarette papersl 1 lot clips, cigarette cases, pouches, containers, air spray, and misc. smoking accessories.

Property is offered for sale both as separate lots and in the aggregate. The property will be sold under the method that produces the highest amount. All bids must indicate which lot the bid is for. Bids for the aggregate must state the bid is for all lots. A separate bid is necessary for each lot or the aggregate.

Property may be Inspected at: 293 S. Sheridan, between 3 p.m. & 4 p.m. on Feb. 14, and between 8:30 and 9 a.m. on Feb. 15.

Submission of Bids: All bids must be submitted on Form 2222, Sealed Bid for Purchase of Seized Property. Contact the office indicated below for Forms 2222 and information about the property. Submit bids to the person named below before the date bids will be opened.

Payment Terms: Bids must be accompanied by the full amount of the bid if it totals $200 or less. If the total bid is more than $200, submit 20 percent of the amount bid or $200, whichever is greater. On acceptance of the highest bid, the balance due, if any, will be ☒ Required in full ☐ xxxxxxxxxxxxxxxxx

Form of Payment: All payments must be by cash, certified check, cashier's or treasurer's check or by a United States postal, bank, express, or telegraph money order. Make check or money order payable to the Internal Revenue Service.

Signature DE Edson	Name and Title (*Typed*) D.E. Edson, Revenue Officer	Date 1-30-80
Address for Information About the sale and Submission of Bids Bids are to be submitted to D.E. Edson, Revenue Officer, between 8:30 and 9:00 a.m. on 2-15-80 at the place of sale. Information on the sale and Bid Forms 2222 can be obtained at Internal Revenue Service, 3525 S. Tamarac Dr. #140, Denver, CO 80237.		Phone 837-2321

Form 2434-A (Rev. 4-75)

Mr. CLANCY. I think I would like to furnish for the record perhaps, a response for that.

Senator NUNN. I have this morning received a copy of a sealed bid auction of seized property. As you know, legislation is pending in the Congress to prohibit the sale of drug paraphernalia. How do you reconcile the Service selling these articles at auction?

Mr. KURTZ. The sealed bid sale of property seized from White Gold Trading Co., Lakewood, Colo., did not occur. Prior to the sale, the taxpayer redeemed the property in question by paying the tax liability.

There currently are no prohibitions in Federal statutes against the sale of drug paraphernalia, and in most States the sale of these items is legal. In the past we have taken the position that assets of this nature can be seized and sold to satisfy tax obligations. We realize that legislation is currently pending before the Congress to prohibit the sale of drug paraphernalia. We are also concerned that the IRS, by offering such items for sale, could place itself in the position of seemingly condoning the use of drugs. Therefore, we have issued instructions to our field offices prohibiting public advertising for and sale of drug paraphernalia.

Senator NUNN. Thank you.

Senator CHILES. Mr. Kurtz.

INTRODUCTION OF ASSOCIATES

Mr. KURTZ. Thank you, Mr. Chairman. There has been some change of cast. Bill Williams, the Deputy Commissioner; Joe Kump, our Fiscal Officer. There are others here: Joe Davis, Assistant Commissioner for Resources Management, and Bob Rebein, Assistant Commissioner for Inspection. Also Art Kallen is Director of the Treasury Department's Office of Budget and Program Analysis.

Since we testified last year, we have two newly appointed Assistant Commissioners and a new Chief Counsel: Russell Dyke, Assistant Commissioner for Planning and Research; Eddie Heironimus, Commissioner for Taxpayer Service and Returns Processing; and Jerry Cohen, our Chief Counsel.

As you say, we have a detailed statement to submit for the record. I would like briefly to summarize a few of the highlights of the request, if I may.

SUMMARY OF BUDGET REQUEST

Our revised budget request for fiscal year 1981 provides for average employment of 89,027 and some $2.359 billion. This is an increase of 843 average positions from the appropriated level for fiscal year 1980. In dollars, the fiscal year 1981 request is $67.6 million more than the requested level for fiscal year 1980. These numbers reflect the President's March 31, 1980 reductions.

I would like to point out that this proposed budget will reduce in 1981 the Service's currently authorized operating levels, after taking into account cost increases and taxpayer population growth for fiscal year 1981. Audit coverage will continue to slip; the unpaid accounts backlog will continue to increase; and we have not budgeted for growth in the number of taxpayers in the taxpayer service program.

Additional resources are requested only in programs where strengthened tax enforcement is particularly essential and workload pressures are especially great. We view these investments as vitally necessary to assure continued confidence in our tax administration system.

A large part of our proposed increase is for the information returns program. This will enable the Service to match a substantial number of wage, interest, and dividend statements with tax returns and to follow through on apparent underreporting of income or nonfiling of tax returns.

Resources are also included to enable the collection program to begin to cope with growing backlogs of delinquent tax accounts where tax liability has already been established but remains unpaid.

Within currently authorized funding, the Service has established, at an executive level, a taxpayer ombudsman to improve and expedite resolution of taxpayer concerns and complaints and to participate in the review and development of policies, procedures, and tax forms in the role of taxpayer advocate.

Within this proposed budget, we have carefully established priorities which stress the mix of programs we believe will do the most to continue present levels of voluntary compliance with the tax laws.

I believe the public's perception of the Internal Revenue Service as an efficient organization, able to deal effectively with taxpayer's questions, examine tax returns and collect taxes that have been assessed, are crucial elements in maintaining voluntary compliance.

Data available subsequent to preparing the budget and subsequent to our testimony before the House on this subject shows our printing costs for the tax packages are up about 20 percent. Also resources are not included to provide for implementing the crude oil windfall profits tax of 1980, and to administer local taxes in the Northern Marianna Islands as contemplated in Public Law 95–348, as amended.

We are also here in support of our fiscal year 1980 supplemental request of $1 million in the payment where energy credit exceeds liability for tax appropriation. While our requested language change to authorize a current year indefinite appropriation will resolve this in fiscal year 1981, this increase is needed in the current year to avoid unnecessary delay and hardship on taxpayers who are due refunds from this account.

Additionally, our request includes a revised fiscal year 1980 supplemental need of $99.2 million to help cover the increased costs of the Government-wide pay raise of 7 percent which was effective October 7, 1979.

Mr. Chairman, my colleagues and I will be happy to answer any questions that you may have.

AUDIT COVERAGE LEVELS

Senator CHILES. For fiscal year 1980, the House Senate conference report directed IRS to maintain audit coverage of 2.24 percent and gave you 750 additional positions and associated resources for that purpose.

The justification material on page 30 shows that IRS, contrary to that direction, is only going to maintain an audit coverage of 2.13 percent in

1980, and proposes to reduce it further in 1981 to 2.03 percent. Why isn't the audit coverage being held at 2.24 percent this year, as directed by the Congress?

Mr. KURTZ. Mr. Chairman, there was a misunderstanding about that. In the Senate, in your committee, we were asked a question of what resources it would take to maintain coverage at 2.24 percent and we answered 1,500 average positions and $30 million.

That was included in the Senate bill. In conference, the 1,500 positions was split, but that was against House reductions of several hundred positions so that the net increase as a result was 546 positions. That is a net increase as a result of the appropriation process of 546 positions, not the 1,500 that would have been required.

Subsequent to that, I did contact Chairman Steed and you to explain the dilemma that we found ourselves in and said that we would do the best we could and devote all of the resources appropriated for auditing to the auditing of tax returns and get the highest coverage we could, but we are a thousand positions short to obtain 2.24 percent coverage.

Senator CHILES. What is the status of the additional positions provided to IRS? How many of those 546 positions are filled?

Mr. KURTZ. We have utilized all of those positions. Our coverage estimate for 1980, as a result of getting these 546 positions, was 2.13 percent.

Senator CHILES. Why, in view of the growing subterranean economy problem does IRS continue proposing reducing the audit coverage level?

Mr. KURTZ. We are proposing our part, Senator Chiles, of the administration's overall budget which, as you know, is a very tight budget this year.

Senator CHILES. My understanding, the reason for that is to balance the budget and save money. I have never quite understood it. I have been told by you and IRS and have heard it for a long period of time that every position we put into audit coverage in IRS gives us a net return. So why are we reducing people in IRS if we are trying to balance the budget?

Mr. KURTZ. I am not sure I am in a position to answer that question.

Senator CHILES. That is what you call a fat pitch, Mr. Kurtz.

You asked for additional positions. I understand they were not granted to you; is that correct?

Mr. KURTZ. That is correct.

Senator CHILES. And you attempted to appeal that to the White House?

Mr. KURTZ. That is correct.

Senator CHILES. What kind of number of positions would it take to have a 2.24 percent coverage and what would it take to have 2.14 percent coverage?

Mr. KURTZ. I will give you that in just a moment. To go to 2.24 percent for our projected coverage would require approximately 2,710 average positions. It is approximate, this is a rough figure, obviously, 110 staff years for each one hundredth of 1 percent coverage. It would be approximately 1,550 average positions to go to 2.14 percent. May I make one other comment?

Senator CHILES. Yes.

Mr. KURTZ. In those numbers, that is not taking into account new auditing responsibilities which we know we would have which would detract from that. That is in the windfall profits tax area; for example, we will have additional auditing needs, which are not included in this request.

INTEREST RATE EXPENSE

Senator CHILES. I understand that you are proposing to increase your interest rate from 6 to 12 percent on overdue refunds paid to taxpayers. That will cost an additional $300 million, increasing that expense category to about $700 million.

What can we do to substantially reduce that expense to the Government?

Mr. KURTZ. I am not sure it is a net expense. The increase in interest cost to 12 percent, which was effective February 1, is mandated by statute. Every other year, based on the prime rate during September or October of the preceding year, the interest rate is automatically adjusted.

That is the interest taxpayers paid Internal Revenue Service and that Internal Revenue Service pays to taxpayers.

Senator CHILES. If it cost us $700 million that we have to pay back, how much do taxpayers pay the Government in interest?

Mr. KURTZ. I don't have that number here, but I can furnish it for the record.

INTEREST PAID TO IRS BY TAXPAYERS

Senator CHILES. This year the interest rate is scheduled to increase from 6 to 12 percent. This increase will require an additional $300 million to pay taxpayers where the Service is required to make interest payments to taxpayers. Would you furnish for the record how much offsetting interest is paid to the IRS by taxpayers?

Mr. KURTZ. For fiscal year 1979, which is the most recent period available, $800 million was assessed by the IRS in net interest, that is, assessments less abatements. Although the assessed interest collected is available on our master file, we do not maintain statistics in this area. Collection of these statistics would involve a sizeable and expensive programing effort.

Senator CHILES. Would it be substantially more than you are paying out?

Mr. KURTZ. Yes.

Senator CHILES. Again, even though it is substantially more, if we can get that error down, we would still be better off. If it is costing us $700 million now and what they are paying back to taxpayers.

Mr. KURTZ. A lot of that, Senator Chiles, is unavoidable in the sense that it occurs through refund claims and not processing delays.

INFORMATION RETURNS PROGRAM INCREASE

Senator CHILES. The first priority for IRS this year appears to be the request for increase in the deterrent program. The initiative starts with requested increases of 286 positions, $5,337,000 for the data processing expense of matching income documents with taxpayer's return information.

Does IRS consider this returns program more important than maintaining the audit coverage level?

Mr. KURTZ. It is really not a question of more or less. The program is a very productive program. With the institution last year of combined annual wage reporting, we are in the position to process many more documents and processing more documents will produce more leads. That program has been effective in identifying nonfilers whereas obviously the audit program focuses on identifying errors in filed returns.

We believe that it does complement the audit program as an overall compliance strategy and that expansion is desirable.

INTEREST AND DIVIDEND WITHHOLDING

Senator CHILES. If the Congress provided the President's request for the early filing of interest and dividends, how much additional funds would IRS need?

Mr. KURTZ. Interest and dividend withholding; we are working now on those estimates and don't have them——

Senator CHILES. You simply would have to ask for a supplemental?

Mr. KURTZ. Yes, it is not clear in the long run there would be an additional cost, although probably there would be some transition costs.

COLLECTION PROGRAM INCREASES

Senator CHILES. In spite of approximately 15 percent increase in collection resources proposed in 1981, the closing inventory accounts receivable is projected to go up to 77,000 or up by 7 percent and the closing inventory of delinquent returns is projected to go up to 107,000 or up by or 13 percent.

Why are the accounts receivable and delinquent returns expected to continue to increase?

Mr. KURTZ. Let me make two comments. First, the increase is not 1,700 positions. It is a net of 919 positions, the balance being a transfer from another appropriation, for Service Center collection work. This transfer is not additional.

We have just simply found the number of unpaid accounts is increasing. We are doing some studies to try and determine just what the reason for it is, but there is no readily identifiable reason. It has been a trend over the last couple of years and one that seems to be continuing.

In fiscal year 1980, delinquent return investigation issuances are less than anticipated, so this area of collection activity may be leveling out somewhat.

Senator CHILES. I have some other questions, Mr. Kurtz, but I am going to submit those to you in writing so that you can answer them for the record.

Mr. KURTZ. We will be pleased to do that.

Senator CHILES. We will get together with you about an additional time for a hearing.

[The following questions were not asked at the hearing but were submitted to the Service for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR CHILES

PROGRAM LEVELS

Question: I understand that in the zero based budgeting process that each agency goes through, the various "decision units" are presented at four levels -- minimum, intermediate, current and enriched. IRS has proposed an increase of $67.6 million and 843 positions even though an increase of 3,500 positions would be needed to stay at 1980 program levels in 1981. Is that correct?

Answer: Yes, the budget request as revised on March 31 proposed net increase of 843 average positions and $67.6 million.

Question: I understand that Treasury appealed to the President for more resources for IRS but was turned down because of the President's interest on holding down overall personnel levels in the Federal Government. Was the Commissioner present at that meeting?

Answer: No, however, the Secretary and the Deputy Secretary of the Treasury were there.

Question: Could you tell the Subcommittee the additional areas that would require resources in order to maintain the current level of 1980 programs in 1981 as well?

Answer: To maintain 1980 program levels in FY 1981, the Service would need some 3,300 additional average positions and about $95 million. Of this total, some 2,350 average positions and about $60 million would be needed to accomplish audit coverage of 2.14%. The balance would be for other Serivce programs, such as appeals, tax fraud, taxpayer service etc. The Examination data includes some 150 average positions to maintain educational skills and tax knowledge for our agents and auditors and about 650 average positions to implement the Windfall Profit Tax.

INFORMATION RETURNS PROGRAM

Question: The first priority of IRS this year appears to be the requested increases for the Information Returns Program. This initiative starts with a requested increase of 286 positions and $5,337,000 for the Data Processing expense of matching more income documents with taxpayer returns information. The balance of the funds are for more Examinations, Investigations and Collection activities to follow up on the leads generated from the additional document matching efforts. Does IRS consider this Information Returns Program initiative more important than maintaining the audit coverage lead? Why?

Answer: No, not more important. But it is an efficient and effective tax administration tool to improve compliance in both the underreporter and nonfiler areas. The Information Returns Program complements the examination effort to preserve voluntary compliance.

Leads identified by document matching are pursued and resolved either through the Service Center corrections program or by a District audit of the returns in question.

We estimate that in FY 1981 we will examine by interview some 40,000 returns in district offices and make some 2 million Service Center contacts by correspondence as a result of document matching leads. Of course, the examinations resulting from document matching are included in our estimated audit coverage of 2.03% for FY 1981.

Question: How does IRS know the number of follow-up leads that will need to be pursued in Examinations, Investigations, and Collections resulting from the increase proposed for information matching?

Answer: Examination receives from our Returns Processing Activity a projection of the number of potential underreporters, plus the number of underreporter notices which will be issued to taxpayers. Using historical data from prior years' programs, Examination applies a percentage to the projected number of potential underreporters plus underreporter notices to be issued. This provides Examination with the estimated number of follow-up leads (cases) to be worked in the Information Returns Program.

Examination - 1981	Number
Potential Underreporters	3,944,000
Underreporter Notices	1,908,000
Estimated Follow-Up Leads (Cases)	416,000

Collection maintains historical data by tax year relating to the volume of information documents processed and the follow-up leads (cases) generated from document matching. This historical data is used to establish the ratio of cases issued to documents processed. Adjustments are made for any processing changes that would affect the number of cases issued. Projections are then made, based on estimates of the volume of information documents to be processed for a specific tax year, for the number of return delinquency cases to be issued.

Collection - 1981	Number
Documents from Correlation	445,000,000
Potential Nonfiler Cases	1,850,000
Estimated - Nonfiler Cases	1,188,000

Tax Fraud Investigations' Information Returns Program follow-up leads (investigations) are estimated for a given fiscal year by applying a formula to the projected number of underreporter notices to be issued to taxpayers. The formula used by Tax Fraud Investigations is derived from historical data relating to the number of cases referred to the districts which subsequently result in criminal investigations.

Tax Fraud Investigations - 1981	Number
Underreporter Notices	2,021,00
Cases Referred to District Offices	9,096
Estimated Total Criminal Investigations	606

Question: Will the expanded effort in Fiscal Year 1981 be primarily for matching interest and dividend information?

Answer: Most of the additional resources we have requested for the Information Returns Program in FY 1981 are for follow-up actions in Collection and Examinations. As a result of Combined Annual Wage Reporting (CAWR) the Social Security Administration is now providing us with wage information on magnetic tape. CAWR has greatly increased the number and the quality of useable wage documents available for matching and, thus, the number of leads requiring follow-up enforcement action.

Our request for the Information Returns Program does include 130 average positions, 62 more than Fiscal Year 1980, to reimburse the Bureau of Public Debt for Series E and EE bond interest data which we will use in our document matching program.

Question: What percentage does interest and dividend income represent of total taxable income?

Answer: For individual income tax returns filed in 1979, the most recent period for which data is available, interest and dividend income formed 7.1% of total adjusted gross income.

Question: Because of the low portion of total income focused on through this initiative, won't the dollar yield be marginal?

Answer: CAWR will enhance our matching of wages which represent a substantial portion, 83.7%, of total adjusted gross income. Because CAWR will give us more and better documents for our document matching program, we expect the return on each dollar spent in Fiscal Year 1981 to be about the same as it is now, between $4 and $5 in net revenue, additional tax assessed less refunds, for each dollar we spend.

INFORMATION RETURNS PROGRAM

Question: Could you describe how this program works, pointing out how the flow of work affects your processing centers as well as your enforcement programs?

Answer: A description of the IRP processing cycle follows.

IRP Processing Cycle

It takes three years for the IRP documents of one tax year to work their way through the system. For example, as of mid-1980, tax year 1979 documents are in the Accelerated IRP stage, that is, the IRP documents are associated with the return prior to examination. Tax year 1978 documents are in the notice issuance stage and work on tax year 1977 documents is being completed by Examination, Collection and Criminal Investigation. Tax Year 1976 documents have gone completely through the system.

When tapes containing wage, dividend, pension and interest information are submitted to the Service Centers, the tapes are checked to ensure each item has a Taxpayer Identification Number. Those tapes which have excessive items without identifying numbers are returned to the submitter. Records are kept of those submitters who send tapes without adequate identifying numbers and repeaters may be assessed penalties if they cannot provide an adequate explanation for such omissions.

IRP Input

Effective tax year 1978, the employers send Forms W-2 (wages) and W-2P (Pension Income) to Social Security Administration (SSA) under the Combined Annual Wage Reporting (CAWR) System. SSA makes up a large tape for their use and then extracts from the tape for IRS the Taxpayer Identification Numbers and income reported. For Tax Year 1978, IRS received 176 million information items. Of these, 157 million were input for full IRP processing.

Forms 1099 and 1087 (dividends, interest, agricultural subsidy, medical payments, and miscellaneous income) and W-2G's (gambling winnings) go to the service centers in either tape or paper form. Of the 311 million such documents received for Tax Year 1977, 67 million (21.5%) were on paper, the rest on tape. Of these, 212 million were input.

Foreign income documents go to Philadelphia Service Center where they must be translated. In 1978, we received 588,000 foreign income documents and input 182,000 of them.

The K-1 documents are schedules attached to Forms 1065 (Partnership), 1041 (Fiduciary) and 1120S (Small Business) received on paper in the service centers. A sampling of these paper schedules are entered onto tape. For tax year 1977 there were 9.4 million K-1 documents received. Of these 3.9 million were input.

IRP Processing

IRP information received on tape is checked to see if it meets prescribed tolerances for containing taxpayer identification numbers. Those that do not are returned to the submitter. The paper documents are "alpha selected " by choosing several letters of the alphabet and then taking those documents belonging to taxpayers with last names beginning with these letters and entering the information from their paper documents onto tape for eventual matching. The transcripts of documents related to the Accelerated IRP program are then divorced from the IRP program and sent to the service centers where they are associated with returns to be examined.

In order to be properly matched, IRS must ensure that the items it has on tape each carry a Taxpayer Identification Number. To do this, we match all the items received against a file provided by SSA. Those items rejected as invalid are then researched and, if necessary, the payee contacted for the proper number.

After perfection of the number, all valid items are sorted in numerical sequence and matched against the master file. Then, depending on the results, the items reported are either shown to match income reported or are generated onto an underreporter or nonfiler tape.

IRP Output

When the underreporter tape arrives at the service center, each item on the tape is checked by pulling the return to ensure that an item actually reported was not missed. Then an underreporter notice is issued and where no reply, an insufficient reply or disagreement is received, the case goes to Examination.

The non-filer tape items are divided into two categories based on dollar tolerances. The low dollar non-filers (approximately 60% of all items on the non-filer tape) are sent up to two notices asking for explanation. Items in this category are matched against a "repeater" file and those non-filers who do repeat are automatically placed in the higher dollar tolerance category.

The 40% in the higher dollar category are sent up to four notices after which any unresolved items are referred to Collection.

The "2 notices only" block represents the only IRP program increase requested in FY 1981. 270 staff years ($5.7 million) are requested to eliminate this "2 notices only" category and give all notices the same treatment. If this is done, additional revenue of $57 million is expected.

Question: With the additional funds requested for document matching in 1981, what percentage of all documents will be matched in Fiscal Year 1981?

Answer: As a result of Combined Annual Wage Reporting (P.L. 94-202), our matching capability has increased substantially. The Social Security Administration is now scheduled to send IRS some 170 million wage documents on tape. These documents, together with the other tape and paper documents, will total about 566 million receipts for FY 1981. These are all Tax Year 1980 documents. As a continuation of our processing of Tax Year 1979 documents in FY 1981, we will attempt to match over 445 million documents. These documents resulted from receipts of 553 million in FY 1980. In FY 1981 the Service will input 80% of Tax Year 1979 documents.

COLLECTION PROGRAM

Question: The second major initiative that IRS proposes in 1981 is to increase its collection efforts with approximately $20.5 million of increases and $13.3 million of resources transferred to it from other areas at IRS. In spite of the roughly 15% increase in collections resources proposed for 1981 the closing inventory of accounts receivable is still projected to go up $77 million or 7% and the closing inventory of delinquent returns is projected to go up $107 million or 13%. Why are accounts receivables and delinquent returns expected to continue to increase?

Answer: We do not know why accounts receivable continue to increase, but we are studying the issue. The improvement in our document matching program is one reason for increases in delinquent return inventories. In FY 1980, however, delinquent return investigation issuances are less than anticipated, so this area of collection activity might be leveling out somewhat.

Question: I understand that IRS has increased the tolerance level on delinquent cases to ease the workload. Is the raising of tolerance levels on cases to be worked in the best interest of taxpayer compliance?

Answer: Ideally, IRS would work each case to completion to ensure equity in every sense as well as maximum compliance with filing and payment requirements. However, because of limited resources, the Service is concentrating its efforts on producing maximum yield; tolerance (deferral) levels have been established accordingly.

Allowing accounts to aggregate to a higher dollar amount serves to reduce the number of taxpayer contacts concerning small dollar delinquencies. Some accounts are offset by subsequent refund returns. In addition, the system ensures that the majority of taxpayers falling within the deferral levels are contacted at least annually. Experience indicates that approximately 80 percent of taxpayers' accounts are either paid, offset, or reissued for collection action as a result of aggregation. An extremely low percentage of accounts are not collected within the six-year statutory period of limitations.

Question: What ultimate effect does the deferring of these delinquent cases have on taxpayer compliance?

Answer: Experience indicates that approximately 80 percent of taxpayers' accounts are either paid, offset or reissued for collection action as a result of aggregation. We do not know the ultimate effect of this on taxpayer compliance.

Question: With predictions of recession, there is a possibility that even more taxpayers will not pay their taxes and the number and dollar amounts of delinquent returns will increase. Describe for the committee the collections programs that you are proposing for 1981 and the internal reorganization that you are proposing to better focus the agency's collection efforts.

Answer: In the 1978 reorganization, the Collection Activity was transferred from Taxpayer Service and Returns Processing to Compliance. Thus, Collection was aligned with other activities whose mission is to deal with compliance problems. As a result, much closer coordination was facilitated among the Collection, Examinations, and Tax Fraud Investigations activities.

The reorganization also reestablished the position of Assistant Regional Commissioner (Collection). Today, there is more direct line of control and improved functional span of control over the accounts receivable and delinquent returns programs.

Finally, we established Service Center Collection Branches (SCCB) at each IRS service center as part of a plan to concentrate more of our compliance efforts there. Our aim is to resolve the high volume of balance due and delinquent return notices, and other taxpayer communications via telephone calls and correspondence at the centers where we attain greater productivity at a lower cost.

EXEMPT ORGANIZATIONS

Question: According to GAO, internal IRS documents show that most of IRS' examinations of exempt organizations result in no change in tax liability or adjustments in tax-exempt status. For example, in a recent year IRS audits of 9,800 exempt organizations resulted in "no change" on 80.5% of the audits and only 3.4% of these audits resulted in revocation of the organization's tax-exempt status. For fiscal year 1981, IRS plans according to the budget submission to reduce the number of examinations of exempt organizations from 20,200 this year to 19,300. In view of the high "no change" examination experience, can IRS make further reductions in the examinations of exempt organizations?

Answer: We have reduced our Exempt Organizations staffing by 20 staff years in our revised Budget request.

However, in the past three fiscal years the no-change rate for exempt organizations examinations has decreased from 81% to 72% and, for the first five months in this fiscal year, the rate is 65%. We believe the improved Selection of Exempt Organizations Returns for Examination (SERFE) and our continued emphasis on quality examination should further reduce the no-change rate in the future. More importantly, however, we feel that our enforcement presence in the exempt organizations community is necessary to maintain high levels of voluntary compliance and to deter abuse of charitable and tax exempt funds. We believe that enforcement coverage should continue at the present level of about 2.5% of the 835,000 organizations recognized as exempt by the Service. Since our 20 staff year reduction will reduce the coverage to about 2.3%, we do not feel resources should be further reduced in this program.

NEW YORK TIMES ARTICLE ON PRIVATE FOUNDATIONS

Question: Mr. Alvin D. Lurie, a former Assistant Commissioner for Employee Plans and Exempt Organizations, stated in a letter to the editor published in the New York Times on November 24, 1979, that IRS during the past five years has examined every single private foundation in this country and has concluded that its saturation examination program was unproductive. Is the former Assistant Commissioner's statement correct and, if so, has IRS cut back on resources devoted to examinations of private foundations?

Answer: After enactment of the Tax Reform Act of 1969, the Service implemented a field program to examine all the private foundations (approximately 29,000) within a five year period (1970 through 1974). Mr. Lurie is correct in that the level of abuse was not so significant as to require a continued saturation program of examining every private foundation every five years. The Service does not have detailed examination results for the full five year period of the 1970-1974 program. However, for the two year period ending September 1974, we have limited information. For that period we recommended additional tax and penalties of $34,774,374 from audits of all exempt organizations, of which $26,527,586 was from the examination of private foundations.

The enforcement presence of the Service in the private foundation community during the five year period had a significant impact from a compliance standpoint. The examinations caused foundation managers and grantors to become aware of their responsibilities under the Tax Reform Act and private foundation funds, previously dormant, commenced being used for charitable purposes. After completion of the five year program, the Service has used a selective program to examine only the returns of these private foundations found to be in most apparent need of audit. We believe the present level of enforcement effort is critical to ensure a high level of voluntary compliance.

TAX SIMPLIFICATION

Question: In implementing the provisions of the Revenue Act of 1978, and GAO's recommendations in its July, 1978 report on simplification of income tax forms and instructions, IRS awarded in September 1979 a $1.2 million contract to redesign and simplify the individual Federal income tax forms and instructions. What is the status of the simplification contract and what scope of work is expected?

Answer: Our contract with Siegel and Gale Inc., who head the consortium studying our tax forms, calls for a review of all individual income tax forms and instructions. The contractor is to make recommendations concerning a simplified filing system for individual income taxpayers and improvements which could be made in the design and readability of both forms and instructions so that they would be easier to use. The study is on schedule and we anticipate submitting a report to the Congress this Fall.

Question: What target dates or milestones have been established?

Answer: The Tax Forms Simplification Study is divided into three basic phases: 1) assessment of existing forms, schedules and related instructions; 2) design of prototype forms, schedules and related instructions; and 3) evaluation of prototype forms and instructions. Phase I was completed, as scheduled, on January 11, 1980. At that time, the contractor recommended two different but compatible approaches for a simplified restructuring of the current system of individual tax forms and instructions. One approach would involve creating separate tax packages for people in different filing statuses. The second approach would entail the development of a new, intermediate tax return, less complex than the present Form 1040 but more accommodating than the existing Form 1040A. In addition to the two structural approaches, the contractor advanced a separate scheme for making the existing forms and instructions more readable.

The Service has authorized the contractor to proceed with the development of rough draft versions of forms and instructions based upon its two structural proposals and upon its readability improvement plan. The contractor is scheduled to make a presentation of its rough draft prototype system to the Service during May, 1980. Meanwhile, the contractor will be working with small groups of taxpayers to test various design and language concepts to be used in the prototype system. At the same time, the Service will be developing statistical sampling plans and cost estimates related to the proposed field testing of the prototype forms during the 1981 filing period.

Our schedule calls for the contractor to submit a report on the prototype system of simplified forms and instructions by September 15, 1980. We will then submit the report, through the Secretary of the Treasury, to the the Finance Committee of the Senate and the Ways and Means Committee of the House. Our submission deadline is November 15, 1980.

The contract continues for an additional year, to permit evaluation and testing of proposals during the 1981 filing period, and to provide for final refinements based upon the test and upon Congressional feedback from the Fall, 1980 report.

Question: What are the major tax forms and instructions that will be improved?

Answer: We think it is possible that the contractor may find many forms and instructions which are not in need of improvement. Notwithstanding, the study reviews Forms 1040 and 1040A, all related schedules and instructions, plus 45 ancillary forms which may be filed with an individual income tax return. In terms of annual usage, some of the more important forms to be reviewed are: the Form 1040, Individual Income Tax Return, Long Form; Form 1040A, Individual Income Tax Return, Short Form; Form W-2, Withholding from Wages; Schedule A, Itemized Deductions; and Schedule E, Supplemental Income.

Question: Will the work also include identifying tax forms that can be eliminated?

Answer: Yes.

Question: Will the estimated tax area for individuals be addressed?

Answer: Yes.

Question: How will this be done?

Answer: The estimated tax area will be reviewed in the same way the other forms and instructions are being reviewed. The study will look to see if the design of the form can be improved to make it easier to use and whether the language in the instructions can be made easier to understand.

USE OF CRIMINAL INVESTIGATORS

Question: Last year the Committee directed IRS to reduce its use of Criminal Investigators for non-criminal work until up to 75% of all background investigations are handled by paraprofessionals or by the Office of Personnel Management. Also, the Committee urged IRS to use its Criminal Investigations staff to improve fraud prevention and other integrity related work. What percentage of background investigations are now done by Criminal Investigators? What will the percentage be at the end of Fiscal Year 1981?

Answer: Our Fiscal Year 1980 ISMIS (Internal Security Management Information System) figures show that as of February 1980, only 6% of the 4,586 background investigations completed were conducted by Criminal Investigators. While we do anticipate some further reductions in this percentage, there is a point where any further reductions are not desirable or cost effective. This is due to the fact that Investigators must still conduct background investigations where serious derogatory information is involved (such as criminal falsification of background information) and where leads and references must be checked in offices whose size does not warrant paraprofessional staff.

RETENTION OF CORPORATE RETURNS

Question: GSA now stores over 400,000 cubic feet of Corporate Tax Returns dating from 1909 at an annual cost over $200,000. We understand that GSA has tried repeatedly over the years to have IRS establish disposition dates for these records. IRS apparently wants the records kept until 30 years after a corporation becomes defunct and GSA wants to dispose of the returns when they are 30 years old. The IRS proposal would result in indefinite retention of many of the corporate tax returns - situation similar to that which exists today. The committee is interested in having disposal schedules developed for this material to reduce the need for additional construction of GSA records centers. Why does IRS need to have this material stored for 30 years after the corporation goes out of business?

Answer: GSA currently stores corporate returns permanently and now has such returns from 1909-1975. While the burden on GSA for maintaining these returns is substantial, the additional tax income to the Government based on information from the returns vastly exceeds storage costs. Several cases, involving millions of dollars, required reference to old corporate returns - dating back to 1909 in one case.

IRS has agreed that returns of corporations, defunct for 30 years or more, may be destroyed and plans to explore the possibility of identifying such corporations. If possible, and cost effective, we then shall determine whether a retention period considerably less than 30 years may be applied to the defunct corporation returns.

FAIR DEBT COLLECTION PRACTICES ACT

Question: IRS Collection personnel are required under an amendment to the 1980 Appropriations Act to follow certain provisions of the Fair Debt Collection Practices Act in regard to taxpayer contacts and harassment of delinquent taxpayers. What effects have these provisions had on IRS collection activities?

Answer: Initially, there was some confusion on how the requirements of the Fair Debt Collection Practices Act related to the unique authority given to the Service by the Internal Revenue Code. However, after looking at the provisions of this Act and our practices, we are satisfied that our collection practices were and continue to be in keeping with the principles of the Fair Debt Collection Practices Act.

The Service, however, believes that these provisions should not properly be part of the Appropriations Act as they legislate substantive direction.

Question: What has IRS done to assure that all its personnel are aware of these limitations and are following them?

Answer: Our personnel were adhering to procedures consistent with the Fair Debt Collection Practices Act prior to the addition of this amendment to the 1980 Appropriations Act. However, to ensure continued adherence, we issued a Manual Supplement, dated 12/26/79, to all Collection personnel.

REVENUE YIELDS

Question: IRS frequently mentions that for every additional dollar it spends, $5 is collected. Obviously some programs will have a higher return than others. What are the comparative yields on an additional dollar for collections, the Information Returns Program, and audit activities?

Answer: The average yield per dollar spent for our various revenue producing programs is:

Examination Program	$5 or $6 per $1
Collection Programs	
Accounts Receivable	$21 or $22 per $1
Notices	$121 or $122 per $1
Taxpayer Delinquent Accounts	$15 or $16 per $1
Delinquent Returns Programs	$12 per $1
Returns Compliance Programs	$3 or $4 per $1

Servicewide Information Returns Program (IRP)	
Gross	$6 or $7 per $1
Less Refunds	$4 or $5 per $1

INTERAPPROPRIATION TRANSFER AUTHORITY

Question: IRS has requested (p. 772 of the President's Budget) that up to 1% not to exceed $5,000,000, could be transferred among its four appropriations accounts. Does IRS contemplate these transfers being made only after appropriation committee review and approval?

Answer: Yes, we will secure approval of the respective appropriations committees prior to the exercise of this requested transfer authority.

RESEARCH AND DEVELOPMENT

Question: IRS has requested a $200,000 increase in R&D activities. Is this increase associated with any particular project?

Answer: No, the increase is being requested to keep pace with rising costs. Our R&D resources remain at about 1/10 of one percent of the IRS budget.

Question: What is the status of the project underway that explains the factors affecting tax compliance?

Answer: This study, begun in FY 1978, is scheduled for completion this spring. The contractor is now making final adjustments and modifications to a report containing conclusions and recommendations on how factors affecting compliance might be isolated and quantified. The report should be available in May. The Service will need to review and assess proposals stemming from the report before developing a follow-up action plan.

Question: What is the cost of this effort?

Answer: The contract was for about $380,000.

Question: Please include in the record a copy of the recent article published in "Psychology Today" which explains why people pay their taxes.

The article referred to follows:

Psychology Today
April, 1979
Volume 12:34

(From Psychology Today, April 1979)

TO DETER TAX CHEATING, LOWER TAXES—BUT RAISE FINES

The best way to reduce tax evasion is to lower taxes and raise fines for the chiselers who are caught, at least according to a study of how 15 psychology students in Israel played an economic simulation game. How often taxpayers are audited seems to be much less important.

Since ethical and legal considerations make it nearly impossible to study real-life tax evasion, Israeli researchers Nehemiah Friedland, Shlomo Maital, and Aryeh Rutenberg substituted a 90-minute simulation, using eight women and seven men with an average age of 25. Each received a folder of forms for reporting income and calculating taxes over four 10-month periods. The students were paid the same theoretical salary, which increased each month for the 40 months. They then "declared" either their salary or, if they chose to cheat, a lower amount. They calculated the tax due on the declared amount, and recorded their spendable net. To ensure the students' interest, the experimenters distributed real money to those with the highest net income when the game was over.

To catch cheaters, random audits were made each month, at a frequency announced in advance of each round (either one or five of the 15 returns). The fine (either three or 15 times the amount the cheater failed to report) was varied so the risks of being fined counterbalanced the risks of being audited; when the frequency of audit was one in 15, the fine was 15 times the underreported amount; when the frequency was five in 15, the fine was three times the underreported amount.

The tax bite was 25 percent for two of the 10-month rounds, and 50 percent for the other two. With the tax rate comfortably low and the fine high, students reported 87 percent of their real income. They reported only 80 percent when the fines were lowered to the less threatening level and the tax rate was kept the same. They were still less honest, reporting only 64 percent of their income, with a high tax rate and high fines; and the amount they owned-up to reached its nadir of 57 percent when the tax rate was high and the fine low.

Before filling out the tax forms, students answered a questionnaire on their backgrounds and interests. The small number of students makes the significance of the results doubtful, but women were more likely to evade taxes than were men (though they underreported smaller amounts). Students who habitually bought lottery tickets did not evade taxes any more often than nongamblers did, but when they did take the plunge, they concealed nearly twice as much income.

—*Jack C. Horn*

Friedland is a senior lecturer at the Department of Psychology, Tel Aviv University, Tel Aviv, Israel. Maital is a visiting lecturer at the Department of Economics, Princeton University, Princeton, N.J. 08540. Rutenberg is a graduate student at Technion-Israel Institute of Technology, Haifa, Israel. Their paper appeared in the *Journal of Public Economics*, Vol. 10, No. 1.

Legal Services

Question: The Legal Services Activity is requesting full funding for its workload increases. Why can't the small 7% workload increase be mandated with productivity improvements?

Answer: The actual need generated by increased Legal Services workloads is for 90 additional average positions. The budget request of 55 average positions is a net increase, after a reduction of 35 average positions for productivity savings. This productivity saving is included in the 1,040 average positions and $16.1 million total productivity goal for the Internal Revenue Service. In view of the increases in case backlogs, and the anticipated surge of case receipts, it would be especially difficult to achieve any additional productivity savings.

Question: $+745,000 is requested to develop and test an integrated Counsel/Appeals Tracking System. What is wrong with the current manual system?

Answer: The case information flow within the Office of Chief Counsel is currently provided by a mixture of seven manual and two automated systems. The existing manual systems require a duplication in data maintained and are cumbersome and time consuming. Manual case control and coordination is unwieldy and leads to inefficient utilization of secretarial support. Manual reports are costly, error prone and difficult to produce on a timely basis.

In summary, the many existing systems do not (1) provide a coordinated, across the board approach to collecting inforamtion in a timely and accurate manner, or (2) make these data available to managers and attorneys when and where needed. In addition, a cost benefit analysis performed as part of the automated tracking system feasibility study projected a five year cost of $10.3 million for the current system compared to an estimated $8.5 million for the automated system.

Question: What will be the associated hardware costs?

Answer: The $745,000 for the integrated Counsel/Appeals Tracking System is the projected first year cost for a system which will be phased in over a three year period. Included in the $745,000 is $534,000 for related hardware costs.

Question: Your budget indicates a continued uncontrollable increase in cases in litigation in your Legal Services Activity. You have requested an increase of 55 average positions in this activity. Could you describe this workload growth and indicate how you would use these additional 55 people?

Answer: The legal services provided by the Chief Counsel's Office can be divided into three major functions: tax litigation, technical tax advice and non-tax legal services. 88% of the projected increased workload is in the litigation functions, and a majority of that is in the Tax Court area, where we represent the Government.

Overall case receipts increased 11% in 1979 and are 49% higher than they were five years ago. However, staffing has increased only 18% during the same five year period. This has resulted in a mounting backlog of cases. Our ending inventory of cases has increased 70% from 1974 through 1979, despite an average yearly increase of over 8% in case disposals. While our annual case disposals per attorney has risen by over 11% during the past five years, the increase in such productivity is limited by our responsibility to carefully represent the Government's interests.

Some 65% of the 1981 projected increase in cases in litigation is in the Tax Court area. Part of this increase may stem from the increasing tendency of taxpayers to resort to this Court, which is the only tax forum that does not require a prepayment of the asserted tax liability. For example, taxpayers filed over 27% more petitions with the U.S. Tax Court in 1979 than in 1978. As you know, the United States Tax Court has recently asked for an increase of 3 additional Judges as a result of its staggering caseload.

The additional 28 attorneys and 27 support personnel will be used primarily in the litigation function, with some staffing increase in the legislation and regulations area to respond to our growing regulations backlog.

MANAGEMENT GENERATED SAVINGS

Question: IRS has an incentive program for permitting managers to keep 50% of the productivity savings that they identify for their highest priority programs. How long has this program been in effect?

Answer: The Service initiated this program in FY 1977.

Question: IRS has presented a total of $4,851,000 in productivity savings. Does this mean that there are actually $9,702,000 in total productivity savings?

Answer: No, the Management Generated Savings incentive is one of several productivity enhancement efforts in IRS.
The revised budget request for FY 1981 reflects productivity savings of some 1,250 average positions and $18.5 million — about 1.4% of currently authorized staff.

Through the Management Generated Savings program, the Service saved last year $3.6 million in total. The managers who were responsible for initiating these cost reduction efforts were able to retain in their financial plans half of the savings for reinvestment in local problem areas. The balance was applied Servicewide toward unbudgeted priorities.

INCREASED PRINTING COSTS

Question: Your budget shows an increase of $8.414 million for printing in Fiscal Year 1981. What is your FY 1980 base printing budget?

Answer: Our appropriated base for printing in FY 1980 is

$52.650 million which represents approximately a 10% increase over budgeted FY 1979 levels. Actual FY 1980 experience reveals the inflation rate in the printing area to be about 20%. As a result, we estimate that a more accurate FY 1980 printing requirement will be $58.215 million, or a full 20% higher than FY 1979 levels.

Question: Can budgeted increases for printing in your FY 1981 budget be held to 5%?

Answer: No, when we formulated the FY 1981 submission now before you, we built in an $8.414 million* printing increase which included the combined effect of an increase for taxpayer population growth and about a 10% increase for anticipated inflation.

Given that our probable revised printing expenditure, or base, for FY 1980 is $58.215 million, the FY 1981 budgeted level of $61.064 million represents $2.849 million over the FY 1980 base and would not allow us to keep up with the expected 20% inflation rate and a continuing 1.5% taxpayer population growth factor. Applying this 21.5% increase factor to our FY 1980 requirement would put the true FY 1981 requirement at $70.731 million. This would represent a shortfall of $9.667 million against our budgeted request of $61.064 million.

Were we to keep the 1981 budgeted increase to 5% over our FY 1980 availability, the FY 1981 would be reduced to $55.283 million which represents a $15.448 million anticipated shortfall against a $70.731 projection.

Climbing inflation rates in the printing industry are a result of a paper market in which demand exceeds supply, labor and materials costs continue to soar, compressed printing schedules are required to print IRS packages and publications, and market conditions continue to fluctuate.

*Appropriation 1 - $ .855 million
Appropriation 2 - $40.275 million
Appropriation 3 - $ 7.174 million
Appropriation 4 - $ 4.346 million

EMPLOYEE PLANS FUNDING

Question: The Employee Retirement Income Security Act of 1974 created new pension plans and required IRS to approve these new plans for compliance with tax requirements. The initial workload created by this law has dropped off approximately 20% since 1979 and yet the budget proposal for Employee Plans and Exempt Organizations drops less than 0.2% in 1981. Can't further reductions be made in the funding for this activity?

Answer: We do not feel further reductions should be made in this area. The level of staffing requested for Employee Plans in the FY 1981 budget reflects a 50 staff year reduction over our FY 1980 resources for this function and a reduction of some 100 staff years over our FY 1979 program. This amounts to approximately a 7% reduction in staff from FY 1979 to FY 1981. These reductions have further delayed our efforts to increase the examination coverage rate to a level that we feel would provide an appropriate compliance program in this area.

Due to the volume of determination workload since the passage of ERISA, the examination coverage rate has been substantially reduced during the past few years. The staff years saved from the anticipated reduction in post-ERISA determination receipts during FY 1981 will be applied to our examination program. Even so, our coverage rate will only be 1.63% of the universe during FY 1981. In subsequent years, we hope to increase the coverage rate to 2.2% to ensure adequate ERISA compliance in plan operation. The FY 1981 Employee Plans examination program includes a continuation of the EP Taxpayer Compliance Measurement Program (TCMP) examinations begun in FY 1980, which will determine ERISA compliance levels and provide a basis for determining EP examination resources for future years. Accordingly, despite the decrease in determination workload, resources cannot be further reduced if we are to ensure compliance through an examination program.

EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS STAFF BREAKOUT

Question: What are the total number of average positions in 1979, 1980, and 1981 proposed to be devoted to Employee Plans versus Exempt Organizations activities?

Answer: The breakout of Employee Plans (EP) and Exempt Organizations (EO) average positions for FY's 1979-1981 is as follows:

	1979 Actual	1980 Estimate	1981 Budget
EP Technical	762	718	682
EP Other	668	672	658
Total EP	1430	1390	1340
EO Technical	559	526	511
EO Other	348	355	349
Total EO	907	881	860
Total Technical	1321	1244	1193
Total Other	1016	1027	1007
Total	2337 1/	2271	2200

1/ Note, the 1979 breakout is only an estimate, based on the FY 1979 budget, because EP and EO average positions are only tracked by Fiscal Management as one combined activity.

PAYMENTS WHERE ENERGY CREDIT EXCEEDS LIABILITY FOR TAX

Question: IRS has requested an additional $1,000,000 for payments where the energy credit exceeds the liability for tax and an annual indefinite appropriation for this program starting in 1981. How many payments are currently on hand for which IRS can make the required refund?

Answer: Through May 2, 1980, the service centers have processed 190 returns with refundable BEITC. A breakdown for individual and business returns and refunds scheduled follows:

	Number	Amount
IMF	290	$507,633.58
BMF	61	88,008.33
TOTAL	351	$595,641.91

The following is a breakdown of refunds during FY 1979 (in which we did not obligate any funds until late in fiscal year).

	Number	Amount
IMF	167	$597,591
BMF	15	72,731
TOTAL	182	$670,322

Question: What information does IRS give those individuals? Please include a copy of the form letter in the record.

Answer: The letter developed for use by the service centers in 1979 to notify taxpayers of delays in their refunds follows:

"We are sorry, but we are unable to refund at this time the portion of Refundable Energy Credit you reported on Schedule B (Form 3468), Part II, that is more than your tax liability.

Congress passed a law in 1978 that requires a separate appropriation for all new refundable credits. A request for the funds has been submitted to Congress and we expect the money to be appropriated in August or September, 1979. As soon as Congress makes this appropriation, the credit will automatically be refunded to you if you have no unpaid taxes (or you did not request on your tax return that it be applied to your 1979 estimated tax). You do not need to take any further action.

Any interest due you will be accrued from the due date of the return or the date the return was filed, whichever is later. It will be included in the refund check (or applied to your tax account).

If you have any questions, please call this toll-free telephone number: enter toll-free number)." (IRM 3(12)G-58 Amend 1)

ADP PLANNING

GAO recently issued a report on how IRS could better plan for and control its ADP resources (GGD-79-48, June 18, 1979). The report noted several significant improvements IRS was planning to make in managing its ADP resources and recommended several actions to enhance these improvements even further.

Question: What is the status of IRS' plans for a long-range ADP planning system?

Answer: Planning for ADP is an integral part of the Service's overall long-range planning process. Resource planning for ADP support, as for all other major programs, requires a 16 to 18 month lead time. The process begins with the development of a Long-Range Plan for the next open budget year and subsequent years. Through this process Service functions identify the level of ADP support required for their respective programs. This input forms the basis for the resource estimates and justifications on which the Data Services Decision Units for the Zero Base Budget Process are prepared.

The Equipment Replacement Program is currently the Service's major plan for replacing the aging computer systems used to support tax processing. The Equipment Replacement Program will provide adequate capacity for present and future workload into the 1990's. Resources required to support ERP have been included in the Long-Range Plan and budget. Additionally, ERP progress is being tracked by Treasury's Zero Base Budget Objectives program.

Policy guidance for the utilization of all ADP resources is provided by the ADP Policy/Resource Board. The Board is comprised of high-level Service executives who review and approve long-range plans, budgets, and work plans which affect the utilization of data processing resources. Their other responsibilities include the development and evaluation of policies which affect ADP support provided to users and evaluation of procedures for planning, controlling, and coordinating ADP support for the Service.

Question: Have GAO's recommendations been implemented?

Answer: Actions have been taken to implement all four of the recommendations contained in GAO's report "IRS Can Better Plan for and Control Its ADP Resources," dated June 18, 1979.

The first recommendation was to develop a cost accounting system. A group studying user funding and related matters has completed a report which includes guidelines for the development and implementation of an ADP cost accounting system. The system will capture and report all ADP developmental and operational costs, broken down by user and user application. Subsequently, the ADP Policy/Resources Board has asked our Fiscal Management Division to develop the necessary procedures for implementation.

The second recommendation was that we formalize standard development procedures. Standardized and formalized systems development procedures have been drafted to assure that major data processing systems are developed consistently, that key activities are done properly and that management has a means to evaluate progress. The procedures include a system life cycle requirement that the objective of each phase of the development process be achieved and evaluated by both users, Data Services, and the ADP Policy/Resources Board, as necessary, before the next phase begins.

Regarding the third recommendation, IRS does utilize a project manager for a number of major systems development activities, especially those with multi-functional implications. Examples of such major projects are the Equipment Replacement Program (ERP), the Information Returns Program (IRP), and the Servicewide MIS Program.

GAO's final recommendation was that IRS establish a comprehensive ADP performance management program. We have established a Computer Performance Evaluation Staff (CPES) reporting to the Director of our Systems Support Division. FEDSIM has assisted us in designing a performance measurement system to be used by the CPE staff.

TAXPAYER OMBUDSMAN

Question: You indicate in your prepared statement that you have established a Taxpayer Ombudsman position in your immediate office. Would you describe the responsibilities of this new office and indicate how it relates to the taxpayer Problem Resolution Program you implemented a year or so ago?

Answer: The Taxpayer Ombudsman has assumed responsibility for administering and evaluating the Service's existing Problem Resolution Program. In addition, he serves as the primary advocate of taxpayers' rights within IRS and represents taxpayers' interests and concerns in the Service's decision-making process. Specifically, the Taxpayer Ombudsman is responsible for conducting reviews of Service policies and procedures that may affect taxpayers and seeking means to ameliorate the negative impact of such policies and procedures; as an ex officio member of the Tax Forms Coordinating Committee, he is responsible for reviewing and proposing changes to tax forms, instructions and publications; he coordinates National level action on systemic and procedural problems that have been found to cause taxpayers to need the services of the Problem Resolution Program; and he oversees the IRS' consumer affairs activities.

VOLUNTEER INCOME TAX ASSISTANCE PROGRAM

Question: I understand the 1981 budget amendments reduce the VITA program from $2.3 million -- or the same level of the program in 1980 -- to $1.8 million.

Answer: The majority of the cut will be taken from the funds available to Tax Counseling for the Elderly (TCE) program sponsors for reimbursing out-of-pocket expenses for volunteers. The Service's FY 1980 Congressional budget request for VITA programs was $1.8 million. Of this, $500,000 was specifically for use in the TCE program. The Senate Appropriations Committee added another $500,000 which was also used in the TCE program. Thus the TCE program was funded by $1.0 million of the $2.3 million appropriated for VITA programs.

The $1.0 million was used for preferential toll-free telephone access for volunteers, special training, additional publicity and reimbursements for volunteers. Even at a reduced level, the expense for telephone access, training and publicity would be close to the same as in FY 1980 - about $250,000. The FY 1981 cut will reduce reimbursements to volunteers from $750,000 to $250,000. Establishing a viable, national TCE program will be very difficult at this funding level.

Question: What is the error rate of VITA prepared tax returns and how does that compare to the error rate generally and to the error rate of other professionally prepared returns?

Answer: The following chart shows the accuracy rate for individual tax returns by category of preparer for 1977, 1978, 1979 and 1980. Professional preparers are referred to as "third party" on the report.

Volunteer Income Tax Assistance Program
ACCURACY RATES

	1977		1978		1979		1980	
	Jan. 1 - July 9		Jan. 1 - July 31		Jan. 1 - July 31		Jan. 1 - March 29	
CATEGORY	1040 FORM	1040A FORM	1040 FORM	1040A FORM	1040 FORM	1040A FORM	1040 FORM	1040A FORM
IRS Prepared Reviewed	98.4	97.6	96.5	98.4	96.2	98.2	95.9	97.6
Self-Help	(This category added in tax year 1979)				95.2	97.0	94.7	96.8
Third Party	93.8	92.4	95.3	96.9	95.4	97.1	95.8	96.6
VITA Prepared	87.0	90.0	92.1	92.2	92.3	93.1	91.9	93.0
Taxpayer Prepared	85.0	87.0	89.6	94.2	89.5	93.7	91.0	93.8
Total Returns Processed	90.7	88.0	93.3	94.8	92.8	94.5	93.7	94.3

Questions Submitted by Senator Schmitt

DISCLOSURE OF TAX RETURN INFORMATION TO STATE AND LOCAL GOVERNMENTS

Question: How extensively are you allowing the states and the local governments to use federal tax information?

Answer: State and local child support enforcement agencies are permitted access to return information pursuant to Internal Revenue Code section 6103(1)(6) for the purpose of establishing or enforcing child support obligations under part D of Title IV of the Social Security Act. Twenty-five State agencies and eleven county agencies have entered into agreements with IRS to receive information from our Master File. During 1979, approximately 23,000 disclosures were made pursuant to these agreements. In addition, we disclosed approximately 165,000 addresses from our files to the Federal Parent Locator Service of the Office of Child Support Enforcement during 1979 for redisclosure to the various State and local child support agencies.

State tax agencies are also permitted access to Federal tax returns and return information for the administration of State tax laws. We have entered into coordination agreements which provide for the exchange of tax information with ninety-two State tax agencies. Local implementing agreements contain tolerances and criteria to assure that State tax agencies receive only information they need and can actually use. Under these agreements, disclosures on magnetic tape are provided to forty-one States from our Individual Master File, twenty-one States from our Business Master File, and five States from our Gift Master File. These disclosures were limited to specifically requested items on the tapes for all taxpayers within the State which could be utilized in a State tax program.

Question: Do you need new or additional restrictions on the use of tax return information?

Answer: No, we believe that existing restrictions on the use of tax return information by State and local governments are adequate.

Question: Share with the Committee your thoughts on whether or not IRS should be required to inform each taxpayer anytime his return is disclosed either in whole or in part and to whom so disclosed?

Answer: From an administrative standpoint, this action would be impracticable, if not prohibitive. Just the cost of notifying all taxpayers of disclosures to State tax agencies under Internal Revenue Code section 6103(d) would be enormous, considering that we disclose information on tapes relative to approximately 90 million taxpayers, a fact which is generally known.

Other provisions of Internal Revenue Code section 6103 provide for large volume disclosures on a continuing basis. For example, 6103(1)(2) provides for disclosures to the Department of Labor and the Pension Benefit Guaranty Corporation for purposes of administration of Titles I and IV of the Employee Retirement Income Security Act of 1974. In calendar year 1979, approximately 200,000 such disclosures were made. In 1979, approximately 200,000 disclosures were made to Federal, State and local child support enforcement agencies under 6103(1)(6) to aid in the enforcement of child support obligations. Additionally, over 500,000 information items on foreign citizens and corporations were provided to foreign countries in accordance with tax treaties with these countries.

Accountings of investigative disclosures made by IRS employees in connection with civil or criminal tax investigations under 6103(k)(6), or to the Department of Justice under 6103(h), are not currently required by 6103(p)(3). Advance notification of such disclosures may hamper our tax administration efforts. Likewise, notification to taxpayers that their returns or return information have been provided to the Department of Justice or other law enforcement agencies under 6103(i)(1), (2), or (3) for use in the administration of nontax Federal criminal investigations, such as organized crime and drug enforcement, would most certainly impair those investigations.

Under the Privacy Act of 1974, taxpayers concerned about the disclosure of their returns or return information may request an accounting of disclosures pertaining to their records. Except for certain instances specified by statute, the Service records each such disclosure on the individual's Master File account at our National Computer Center in Martinsburg, West Virginia. Upon receipt of a Privacy Act request, the Service will provide a Privacy Act Transcript showing the date and the recipient of any disclosure.

The Service feels that the current recordkeeping and accounting procedures under the Privacy Act of 1974 and Internal Revenue Code section 6103(p)(3) serve to provide taxpayers with necessary information concerning the disclosure of their tax records. We would oppose any recommendation for automatic notification because of the administrative and resource costs involved.

FRAUDULENT REFUND PROGRAM

Question: Last year I inquired about the reports of fraudulent tax refunds, cases of refunds being issued to individuals who never even paid any taxes. In your reply you stated that your program of detection "normally does not stop fraudulent refunds before payment." What can be done to verify refunds before they are made without unreasonably delaying refunds? Do you have any information as to the scope of this problem at this time? Has it increased or decreased?

Answer: It is difficult, at this point, to judge what the scope of the problem might be. Obviously, we do not know what we are not detecting. We have undertaken a study involving tax year 1978 information to try to arrive at some measure of the universe, based on a statistical sampling of returns.

Some three years ago, the Service began systematic efforts to improve its capabilities in the identification of questionable refund returns. This new approach, called the Questionable Refund Program, made better use of IRS personnel and expanded use of the Service's computers, both at the ten service centers and the National Computer Center, and required coordination between service centers in the detection and screening of questionable refund returns. It also emphasized National Office coordination of the program. This high priority program became operational in January 1977.

The Questionable Refund Program has shown tangible results. In 1976, prior to the implementation of the program, the IRS discovered 46 potential questionable refund schemes involving 1,645 returns.

But in calendar year 1977, after the Questionable Refund Program had started, we found 359 potential schemes involving 3,378 returns. That is, with the Program in operation, IRS detected nearly eight times more potential questionable refund schemes than under prior procedures. This program also allows us to prevent the issuance of questionable refunds. The amount of questionable refunds identified in 1976 came to slightly more than $3 million. Of that, IRS issued about $940,000 in refunds, thus deleting about 65% of the refunds claimed before issuance. During 1977, 82% of the refunds claimed were deleted before being issued, with 98% deleted during the first three months of 1980.

Period	# Schemes Detected	# Returns Involved	$ Refunds Claimed	$ Refunds Deleted	% Refunds Deleted
1/80-3/80	121	2,013	$ 4,951,704	$ 4,864,743	98%
1979	404	1,775	1,993,168	1,732,552	87%
1978	512	3,316	3,973,313	3,383,719	85%
1977	359	3,378	$ 4,721,969	$ 3,886,395	82%
Total	1,396	10,482	$15,640,154	$13,867,409	89%

Since the beginning of the program, in January 1977, 821 criminal tax fraud investigations have been initiated; 118 of them are still underway as of February 1980. From January 1977 thru February 1980, the IRS has made 472 criminal tax fraud prosecution recommendations; 209 convictions have resulted, including 189 guilty pleas.

We believe that the Questionable Refund Program is a realistic program which has shown reasonable results. But just as we cannot audit every tax return which should be audited, or work every case that has some compliance potential, we cannot assure that every questionable refund claim is identified. The sheer volume of refunds involved makes that impossible. Our efforts to stop questionable refunds before payment must also take account of the needs of honest taxpayers to have their refunds processed expeditiously. Our programs since 1977 have effectively identified numerous questionable refund schemes, have stopped a large number of questionable refunds prior to payment, and have resulted in criminal investigations and convictions. The results of this program should serve as a substantial deterrent to those who might be tempted to engage in this type of fraud. We will continue to work to refine our methods of identifying questionable refunds while timely processing legitimate refund claims.

CONTACTS WITH TAXPAYERS

Question: In his book, All You Need to Know About the IRS: A Taxpayer's Guide, Paul Strassels claims that the IRS relies on intimidation in its dealings with the taxpayer. Would you care to comment on that statement by Mr. Strassels who was an employee of the IRS for five years? How do you explain many complaints of harassment and intimidation which virtually every Member of Congress receives each year?

Answer: With an organization of some 85,000 persons dealing with more than 90 million taxpayers, some problems will occur. We try to minimize these occurrences through effective policies and procedures, and through training and supervision of our employees. It is our policy that...

> "(tax) administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud." 1/

Our procedures provide our employees clear guidance on advising taxpayers of their rights at all stages and in all types of enforcement activities. These procedures also clearly define for our employees, limitations on the exercise of the authority to determine, assess, and collect taxes granted by the Internal Revenue Code.

Our policies and procedures have been reviewed and revised over the years. In some instances, we have done so to incorporate suggestions made by our Congressional Oversight Committees, the General Accounting Office, the Administrative Conference of the United States, and our own Internal Audit Division. We will continue to review our policies and procedures and will revise them when a need for revision is demonstrated.

These policies and procedures, and the judgment normally exhibited by our personnel, permit us to state that our personnel generally perform an extraordinarily difficult task well. When the Administrative Conference of the United States studied our collection practices in 1975, its staff report noted:

> "The Internal Revenue Service which is (our tax gathering) mechanism, performs a task of stupendous scale...to which the public is uniquely sensitized. Given the speed and the impersonality which this mission requires, the number of complaints voiced is remarkably few. The number of valid complaints is fewer still." 2/

Nonetheless, we recognize that mistakes are made. To assist taxpayers who believe we are in error and have been unable to resolve their problems through normal channels, we have Problem Resolution Officers in each of our Districts and Service Centers. We also recently established a Taxpayer Ombudsman in the Commissioner's office, who supervises our Problem Resolution Program and acts as a taxpayer advocate.

1/ The "Statement of Principles of Internal Revenue Tax Administration" appears on the second page of each issue of the Internal Revenue Bulletin.

2/ Subcommittee on Oversight of the Committee on Ways Means, U.S. House of Representatives, "Collection of Delinquent Taxes: A Report to the Steering Committee for the Internal Revenue Service Project of the Administrative Conference of the United States," p. 27. (January 20, 1976).

SUBCOMMITTEE RECESS

Senator **CHILES**. We will recess until 2 o'clock.

[Whereupon, at 1:05 p.m., Thursday, April 22, the subcommittee was recessed, to reconvene at 2 p.m., the same day, in room S–146, the Capitol.]

(AFTERNOON SESSION, 2:30 P.M., TUESDAY, APRIL 22, 1980)

[The subcommittee reconvened at 2:30 p.m., Tuesday, April 22, 1980, in room S-146, the Capitol, Senator Chiles presiding.]

Present: Senators Chiles and Schmitt.

STATEMENT OF ALICE RIVLIN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

OPENING STATEMENT OF SENATOR CHILES

Senator CHILES. This afternoon the committee will receive testimony from the U.S. Postal Service and from several agencies of the Department of Treasury. The two Treasury bureaus that we will hear testimony from this morning are International Affairs and the Bureau of the Mint with a combined budget request for fiscal year 1981 of $84,627,000. The committee will discuss various questions of overlapping functions, activities, and responsibilities between the programs and activities of the International Affairs programs at Treasury, and those similar programs at the Department of State and the Department of Commerce.

With the Bureau of the Mint the committee intends to discuss the Department's overall currency strategy and the Bureau's near-term production capability to meet the demand for coinage. The committee will not receive testimony from the Bureau of Engraving and Printing. Their statement will be put in the record and a number of questions will be submitted to them for the record.

[CLERK'S NOTE.—The material is printed following the Bureau of the Mint's testimony.]

CONTINUATION OF STATEMENT

The committee, however, intends to continue to monitor the efforts of the Bureau of Engraving and Printing to implement the needed management improvements that were recommended by the Department last year.

The committee will begin receiving testimony this afternoon from Ms. Alice Rivlin, Director of the Congressional Budget Office. The committee requested the Congressional Budget Office to make a study of the need and continuing economic justification for postal subsidies.

Senator Schmitt, do you have an opening statement?

Thank you for making the study for us.

Ms. RIVLIN. Thank you, Mr. Chairman.

STATEMENT OF CONGRESSIONAL BUDGET OFFICE

The Federal Government currently supports the U.S. Postal Service through two main types of payments. One for revenue forgone because of reduced postage for certain mailers, and another for public services that are not cost effective. Last year you asked the Congressional Budget Office to undertake a study of Federal payments for revenue forgone and to analyze budgetary alternatives. I am pleased to be here today to present the results of our analysis.

My statement this afternoon will cover three points: The composition and growth of the revenue forgone subsidy; the significance of the revenue forgone subsidy to nonprofit organizations, the general public, and the Postal Service; and finally, alternatives the Congress might consider concerning the future of the revenue forgone subsidy.

Our findings are based largely on information provided by the Postal Service and the Institute for Social Research at the University of Michigan. The Institute conducted a detailed survey of mail received by households during 1977.

The second type of Federal payment—for services such as Saturday mail delivery that are not cost effective—was not addressed in our study.

COMPOSITION AND GROWTH OF THE SUBSIDY

In the past, two major groups of mailers, commercial and nonprofit, were eligible for these reduced postage rates and thus for a subsidy financed by appropriations that make up for revenue lost because of lower rates. Subsidies to most commercial magazines and newspapers were phased out over an 8-year period ending on July 6, 1979. The second group of preferred mailers, mainly nonprofit organizations and small newspapers, is still subsidized. Despite the fact that a portion of the subsidy to these mailers is being phased out through 1987, increases in mail volume and postage rates have caused the level of appropriations to more than triple over the past 8 years—from $229 million in 1972 to $726 million in 1980 (see table 1).

TABLE 1.—*Revenue forgone subsidy, fiscal years 1972–80*

[In millions of dollars]

	1972	1973	1974	1975	1976	1977 [1]	1978	1979	1980
Subsidy to commercial mailers, phased out in July 1979	212	221	195	226	261	264	206	135	[2] 9
Ongoing subsidy [3]	229	237	302	387	463	575	596	665	726
Total subsidy	441	458	497	613	724	839	802	800	735

[1] Includes $46.7 million appropriated in fiscal year 1980 for shortfall in amounts requested in fiscal year 1977.

[2] While subsidies to most commercial mailers expired on July 6, 1979, postage rates for agricultural science and certain other small-circulation commercial publications are still subsidized.

[3] Mostly to nonprofit mailers.

APPROPRIATION REQUEST FOR FISCAL YEAR 1981

The Postal Service is requesting $789 million to be appropriated in fiscal year 1981 for revenue forgone. This estimate includes $111 million for shortfall in amounts requested in prior years. The remaining $678 million is for estimated revenue forgone in 1981 and is distributed among seven subclasses of reduced rates. The largest portion of this amount is for second and third class mail sent by nonprofit organizations, and accounts for about half the cost of delivery. Most of the remaining subsidy for fiscal year 1981 goes for library material—$70 million—and for magazines and newspapers mailed within the county of origin—$40 million. The so-called within-county subsidy benefits small-circulation publications—largely those in small towns and rural communities. The subsidy for library and within-county publications covers about 65 and 50 percent of postal expenses for these two categories (see table 2).

TABLE 2.—*Distribution of revenue forgone subsidy of $678 million for fiscal year 1981* [1]

	Subsidy		Average postage rates per piece		
	Millions of dollars	Percent of total	Full rate	Reduced rate	Subsidy
Nonprofit organizations:					
Second class	$102	15	$0.08	$0.04	$0.04
Third class	420	62	.09	.04	.05
Within county	40	6	.06	.03	.03
Library material	70	10	1.51	.53	.98
Other subclasses	46	7	(2)	(2)	(2)

[1] Excludes $111 million requested for shortfall in prior years.
[2] Estimates of average rates are not meaningful.

FUTURE COSTS

According to the estimates of the Postal Service, which do not assume a rate increase until 1984, revenue forgone appropriations will total about $4.6 million through fiscal year 1985. If rate increases occur before 1984, outlays for revenue forgone will be higher. CBO's 5-year current law projections are based on an annual break-even concept—that is, postage rate increases are assumed to occur each year in order to cover projected costs. Under this assumption, costs for revenue forgone are projected as higher than those estimated by the Postal Service, totaling about $5.8 billion through fiscal year 1985 (see table 3).

TABLE 3.—*Projections of revenue forgone subsidy, fiscal years 1981–85*

[In millions of dollars]

	1981	1982	1983	1984	1985	5-year total
USPS estimates	[1] 678	915	870	1,135	1,029	4,627
CBO estimates	878	1,112	1,174	1,301	1,286	5,751

[1] This amount does not inlcude $111 million requested in fiscal year 1981 for shortfalls in fiscal years 1974–76 and 1978.

SIGNIFICANCE OF REVENUE FORGONE SUBSIDY

The revenue forgone subsidy is intended to promote the flow of religious, educational, cultural, and charitable materials. It affects both the nonprofit organizations that send much of this material and the households that receive it. The Postal Service, which is reimbursed for delivery of mail at reduced rates, is not directly affected by the revenue forgone subsidy.

EFFECT ON NONPROFIT ORGANIZATIONS

Nonprofit organizations benefit most from revenue forgone appropriations, requiring nearly three-quarters of the funds requested for fiscal year 1981.

About two-thirds of the mail sent by nonprofit organizations is subsidized (see table 4). Religious organizations are the heaviest users of reduced rates—in 1977 they accounted for 53 percent of the second class subsidized mail received by households and 42 percent of third class nonprofit bulk mail. Educational, scientific, and charitable organizations also use subsidized rates extensively (see table 5). In 1977, political organizations eligible for subsidized rates were limited to various public interest groups. In 1978, eligibility for third class reduced rates was expanded to include national and state political party committees.

TABLE 4.—*Use of subsidized rates by nonprofit organizations, 1977*

Type of organization	*Percent of mail subsidized*
All nonprofit	67
Religious	82
Educational, scientific	56
Charitable	58
Labor, veterans	85
Fraternal	64
Political	32

TABLE 5.—*Percent distribution of mail received by households from nonprofit organizations, 1977*

	Type of nonprofit organization				
	Total	Religious	Charitable	Educational-scientific	Other [1]
All mail	100	38.6	12.4	36.2	12.9
Distribution of select subsidized subclasses: [2]					
Second class reduced rate [3]	100	53.2	2.0	23.1	21.7
Third class nonprofit bulk rate	100	42.1	16.1	33.8	8.0

[1] Includes labor, veterans, fraternal, and political organizations.

[2] The classes selected represent 68 percent of total nonprofit mail received by households.

[3] Includes the following reduced-rate subclasses: within county, regular rate, nonprofit, classroom, and controlled circulation.

Nonprofit organizations use reduced rates for mailings of publications as well as requests for contributions and billings. Our analysis indicates, however, that in general they do not appear heavily dependent on this form of support. Even if subsidized postage is not considered, nonprofit organizations will receive, in fiscal year 1980, an estimated $11.8 billion in Federal grants and tax expenditures for charitable contributions. When measured against the aggregate income of nonprofit organizations, revenue forgone appropriations again seem small. Excluding religious groups, for which data are generally unavailable, revenue forgone funds represented less than 0.2 percent of net nonprofit income reported in 1978. These comparisons, of course, cover a wide variety of activities and organizations; and revenue forgone funds may be more important to some than to others. Reduced postage, for example, is a significant fund-raising saving for organizations that rely heavily on mail solicitation as a source of income.

EFFECT ON THE GENERAL PUBLIC

In 1977, the average household received about 1.5 subsidized pieces of mail per week from religious, educational, charitable, and other nonprofit organizations. The mail from nonprofit senders, however, is shared disproportionately by households of different income groups. The notion that postal subsidies make a variety of information available to citizens who might not otherwise be able to afford it is not supported by our analysis. Higher income households receive a portion of nonprofit mail that is far greater than their proportion of the population. Nearly one-third of the subsidized third class mail sent by all nonprofit organizations in 1977, for example, went to the 16 percent of households with annual incomes of $25,000 and over. Conversely, households with incomes under $5,000 represented about 16 percent of the population but received less than 10 percent of the mail from nonprofit organizations (see table 6).

TABLE 6.—*Nonprofit mail received by households related to household income, 1977*

[In percent]

	Household income				
	Total	Under 5,000	5,000 to 9,999	10,000 to 24,999	25,000 and over
Distribution of households	100	15.5	20.2	48.9	15.5
Distribution of all nonprofit mail [1]	100	6.6	13.0	48.5	31.9
Distribution of third class nonprofit bulk mail	100	6.8	13.8	47.1	32.4

[1] Includes subsidized and nonsubsidized mail.

EFFECT ON THE POSTAL SERVICE

The Postal Service estimates that in fiscal year 1981, it will deliver over 14 billion pieces of subsidized mail at an estimated cost of $2.2 billion. The budget request assumes that income from subsidized rates will cover $1.5 billion of this cost and that the balance, $678 million, will be paid by the taxpayer through appropriations to the Postal Service. Under current projections, revenue forgone appropriations will continue to represent about 4 percent of total postal revenue through 1985. If the Congress does not appropriate the amount requested in a particular year, the Postal Service is required by law to increase correspondingly the rates paid by subsidized mailers. Thus, the level of income to the Postal Service would remain essentially the same, and postal operations would not be noticeably affected.

FUTURE ALTERNATIVES

In the past, the Congress has legislated low postage rates for certai mailers in order to encourage the flow of opinion and ideas and to sup port charitable causes. Under the current system, budget outlays woul reach $1 to $1.3 billion for revenue forgone in fiscal year 1985. Thes costs would be even greater if the Congress enacted proposals t expand eligibility for reduced rates. For example, provisions in H.R. 79 which passed the House last September, would expand the eligibilit for fourth class library rate subsidies. If such provisions were enacted CBO estimates outlays would increase by $200 million over the next years.

This year, the Congress is considering reductions in payments to th Postal Service as part of an effort to balance the budget. In this context there are two possibilities the Congress could consider concernin revenue forgone appropriations: Discontinue appropriations for revenu forgone and eliminate subsidized rates; or discontinue appropriation for revenue forgone but shift the cost of reduced rates from the taxpayer to all mail users. Either approach could be fully implemented i fiscal year 1981, or gradually over a number of years to lessen it impact.

DISCONTINUE APPROPRIATIONS AND ELIMINATE SUBSIDIZED RATES

Discontinuing appropriations for revenue forgone would achieve significant budget reductions. If fully implemented in fiscal year 1981, the President's budget estimates would drop by $789 to $878 million. Over the next 5 years, cumulative reductions would reach $4.7 to $5.8 billion. The amount of the savings depends on the timing of future postage rate increases. If appropriations were gradually eliminated through fiscal year 1987, cumulative 5-year savings would reach $0.9 to $1.2 billion (see table 7).

Under current law, cuts in revenue forgone appropriations would have the effect of reducing or eliminating existing postage subsidies. If the Congress cut appropriations, the Postal Service would have to increase the rates paid by subsidized mailers in order to make up the associated loss in income. If appropriations were completely eliminated in fiscal year 1981, postage rates that are now subsidized would thus increase an average of 45 percent.

Increases in rates currently subsidized would not likely decrease mail volume in the long run. According both to models used by the Postal Service for projecting mail volume and to measures of price elasticity used by the Postal Rate Commission, the volume of subsidized mail is mainly affected by economic conditions rather than by moderate changes in postal rates. Our analysis for the 1972–79 period indicates that even substantial rate increases are not necessarily accompanied by decreases in volume.

Proponents of subsidized rates argue that they should be continued in the interest of promoting the flow of news and of educational, cultural, literary, and charitable materials. The use of subsidized postage rates for such purposes, however, may be challenged as not targeting budget expenditures on specific national priorities, resulting in heavy use of mails for charitable appeals, and as providing unnecessary support to nonprofit organizations.

TABLE 7.—*Budget savings from discontinuing revenue forgone appropriations*

[In millions of dollars]

	From USPS estimates [1]		From CBO estimates	
	1981	Thru 1985	1981	Thru 1985
Full implementation in 1981	789	4,738	878	5,751
Implementation thru 1987	155	929	56	1,252

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[1] Estimated savings assume the request for shortfalls in prior years would not be appropriated.

DISCONTINUE APPROPRIATIONS BUT SHIFT THE COST OF REDUCED RATES TO ALL MAIL USERS

Another possibility for achieving budgetary savings in revenue forgone appropriations would continue subsidized rates but shift their cost to all mail users. Under this approach, the cost of subsidized postage rates would be treated as an overhead expense of all postal operations. From this perspective, postage rates would increase an average of 4 percent to offset the elimination of revenue forgone appropriations. This option, requiring amendment of authorizing legislation, would achieve the same budgetary savings as an elimination of subsidies solely through appropriation action. Likewise, such an approach could be fully implemented in fiscal year 1981 or gradually over a period of years.

Thank you, Mr. Chairman.

Senator CHILES. Thank you, Ms. Rivlin.

SUBSIDIZING NONPROFIT ORGANIZATIONS

Your figures are very interesting, especially when you point out that revenues forgone represent less than 0.2 percent of the net nonprofit income reported in 1978.

Ms. RIVLIN. That is the total income of eligible nonprofit organizations.

Senator CHILES. Does that figure contain any information on religious organizations?

Ms. RIVLIN. No. It doesn't because we didn't have any income figures for them.

Senator CHILES. Then you have left out also the income figures on religious organizations?

Ms. RIVLIN. Yes. It is left out on both sides.

Senator CHILES. The cost of subsidizing the nonprofit organizations has almost tripled since 1972. And the subsidy goes primarily for religious, educational, cultural, and charitable nonprofit organizations. Approximately 10 percent of the mail received by an average household is mail in this category with higher income households receiving a larger share or higher percentage of the share.

Ms. RIVLIN. That is right.

Senator Chiles. You also indicate that the postal subsidies represent on the average only 5 percent of the Federal aid to nonprofit organizations and that the subsidies represent less than one-half of 1 percent of the net income received by the nonprofit organizations.

You also feel from your study that if the subsidies were eliminated and if postal rates were increased the mail volume of this category of mailers would not necessarily drop.

Ms. Rivlin. The evidence seems to be that the mail volume is not very responsive to changes in the rate.

Senator Chiles. It sounds as if while the cost continues to increase the benefits to the mailers are not significant enough to cause them any great harm if the subsidies were eliminated and also since mail volume would not necessarily drop by having the rates increased, the Postal Service then would not be harmed.

Ms. Rivlin. The Postal Service will cover the costs one way or the other.

Senator Chiles. If the mailing subsidies were eliminated to nonprofit organizations, do you believe there would be any significant adverse impact on these organizations or any particular grouping of the organizations?

Ms. Rivlin. It is hard to tell about some groups. As we said in the statement, those who depend heavily on the mail solicitations would certainly find it more difficult to do without reduced postage. The revenue forgone subsidy may be more important to some groups than to others.

ELIMINATION OF SATURDAY MAIL DELIVERY

Senator Chiles. I would like to ask you another question on the Postal Service. As you know, the President in last month's budget amendments proposed a $250 million reduction for eliminating Saturday mail delivery. The House and Senate Budget Committees also proposed eliminating Saturday mail delivery but they have substantially higher figures associated with such an elimination. If Saturday mail delivery were eliminated what budgetary savings could we expect as a result?

Ms. Rivlin. A 1981 estimate for the saving on Saturday mail delivery ranges between $600 and $650 million. This would be consistent with Postal Service data as we understand it.

Senator Schmitt. What do you think of the number, $250 million?

Ms. Rivlin. Our analysis was an update of information based on 1980 budget assumptions; it indicated that the savings on a full-year basis would be somewhere in the neighborhood of $600 to $650 million. That estimate assumes that Saturday delivery would be eliminated at the beginning of fiscal year 1981.

I believe that the $250 million provided in the President's March estimates assumed it would be implemented much later in the fiscal year, not in the beginning.

Senator Chiles. Delay in time?

Ms. Rivlin. Yes. It is the savings for only a partial year.

Senator Chiles. So we are really talking about in the neighborhood of the same amount of money whether it is Saturday delivery or both of them.

Senator Schmitt. That was my next question, how do you see the tradeoff between the two? We had better go vote.

Senator Chiles. Thank you very much for your testimony. Do you have further questions?

Senator Schmitt. Just maybe either for the record or very quickly you could comment. If we had to make a choice of either Saturday mail delivery or less subsidized mail, would you see any basis for such a choice?

Ms. Rivlin. Not off hand. But why don't we think about that for the record?

Senator Chiles. General Bolger will be up next and we may have two votes back to back.

[Discussion off the record.]

[The information follows:]

REDUCTION IN REVENUE FORGONE VS. PUBLIC SERVICE FUNDS

Budget reductions could be considered in either or both types of federal payments to the U.S. Postal Service: that is, appropriations for revenue forgone and public services. Each payment serves a different purpose and should be reviewed on its own merits. The revenue forgone funds benefit certain mailers who enjoy reduced postage rates, while the public service payment helps support certain services to the public that are not cost effective, such as Saturday delivery. Although it is impossible to formulate criteria for trading off reductions between the two payments, some comparisons may be possible concerning the potential impact on the budget, the general public, special groups, and the Postal Service. The following comparisons assume each payment would be completely eliminated in fiscal year 1981, although either or both could be discontinued in part or gradually over time.

Budget. Discontinuing payments for revenue forgone would achieve budget reductions totaling $4.4 to $5.5 billion through 1985. Discontinuing public service payments would result in relatively smaller five-year savings, estimated at about $2.8 billion, because the authorization is already scheduled to drop by $92 million a year through 1984.

General Public. The revenue forgone subsidy is intended to promote the flow of religious, educational, cultural, and other material. Analysis suggests that the volume of this material received by the public would not necessarily decline if revenue forgone payments were reduced. The use of subsidized postage rates for promoting the flow of certain material may be criticized as failing to target federal resources to specific programs and causing heavy use of mails for charitable appeals.

A reduction in mail deliveries from six to five days per week would likely be one consequence of discontinuing public service appropriations. Such action would affect most citizens to some degree although the convenience of Saturday mail is a service the general public could possibly manage without. Although some business and personal routines would be adversely affected, it should be noted that there are already at least nine weeks in the year when mail is delivered only five days because of federal holidays.

Special Groups. Elimination of revenue forgone appropriations would mainly affect nonprofit organizations and other groups that use subsidized postage rates. They would have to pay higher postage rates if federal payments were discontinued. As a group, however, these mailers do not seem to depend heavily on the support provided through subsidized postage--revenue forgone funds represent less than 0.2 percent of the net income of nonprofit organizations in 1978. Reduced postage, of course, may be more important to some organizations than to others--for example, those that depend heavily on mail solicitation as a source of income.

Discontinuing the public service payment might also reduce the access of persons in some rural areas to postal facilities if rates were not correspondingly increased to offset loss of public service funds. In addition, the Postal Service and the postal unions are concerned that workers would lose their jobs if Saturday delivery were discontinued. Eliminating Saturday mail could probably be achieved largely without laying employees off because of vacancies occurring in delivery positions, potential for cutting back on overtime, transfer of delivery personnel to clerk and mailhandler positions that also become vacant.

Postal Service. If revenue forgone payments were discontinued, the level of income to the Postal Service would remain essentially the same, and postal operations would not be noticeably affected. Under current law, the Postal Service is required to increase subsidized rates to make up the loss in income if revenue forgone appropriations are reduced. Elimination of public service appropriations would decrease postal income, and likely result in service cutbacks. Current services could continue, however, if postage rates were increased accordingly.

U.S. POSTAL SERVICE

STATEMENT OF WILLIAM BOLGER, POSTMASTER GENERAL, U.S. POSTAL SERVICE

ACCOMPANIED BY:

- CARL ULSAKER, SENIOR ASSISTANT POSTMASTER GENERAL, EMPLOYEE AND LABOR RELATIONS GROUP, U.S. POSTAL SERVICE
- C. NEIL BENSON, SENIOR ASSISTANT POSTMASTER GENERAL, OPERATIONS GROUP, U.S. POSTAL SERVICE
- JIM FINCH, SENIOR ASSISTANT POSTMASTER GENERAL, FINANCE GROUP, U.S. POSTAL SERVICE

BUDGET REQUEST

Senator CHILES. The committee will now receive testimony from the U.S. Postal Service regarding the fiscal year 1981 budget requests. $1,593,217,000 and 532,128 permanent positions have been requested for fiscal year 1981.

This request with the President's budget revisions for fiscal year 1981 would be $1,343,217,000. The committee is pleased to have Mr. William Bolger, the Postmaster General, with us today to present the testimony in support of this request. We will submit your full statement in the record and if you could provide us some highlights of it.

[The statement follows:]

STATEMENT OF WILLIAM F. BOLGER

Mr. Chairman, we are here today to go over the Postal Service appropriations request for fiscal year 1981.

The Postal Service has requested an appropriation of $1,593,217,000 for FY 1981. This is $83,593,000 less than the amount appropriated for FY 1980.

I am pleased to report that the Postal Service is doing much better than we did in the previous period of double-digit inflation back in 1974. Our net $470 million operating income last year gave us the first year in the black since 1945. Through the first 24 weeks of FY 1980, we had a net income of $130.6 million. During February and March, however, we were back in the red. The cost-of-living clauses in our labor contracts, together with rising energy and other costs, will result in an operating deficit when the final returns are in for the current fiscal year. We presently expect it to be about $593 million.

These new deficits mean that early in calendar year 1981 we will need to put into effect our first general rate adjustment since May, 1978. Keeping rate levels steady that long is a remarkable achievement for the postal system in these tremendously inflationary times.

Our appropriation request this year covers the usual three elements: public service costs, revenue forgone for free and reduced-rate postage, and transitional costs left over from the activities of the former Post Office Department.

Public Service Appropriation

The public service appropriation authorized for FY 1981 is $736 million. This is the second step down from the $920 million which we received during the 1970's. Present law provides for this appropriation to level off at $460 million beginning in FY 1984, unless the Postal Service determines it is no longer needed.

The public service appropriation is intended as a general supplement to postal revenues in light of the many public services which the postal service performs. In receiving the benefits of a universal postal system serving low-volume areas as well as high-volume areas, our customers are not always expected to pay dollar for dollar for the costs of the services they use.

In FY 1972, this authorization covered about 10 percent of the Postal Service budget. For FY 1981 it is less than 3-1/2 percent.

As you know, the Administration and the Congressional Budget Committees have recommended cuts in this appropriation for FY 1981 and the next two years. The size of these cuts, which would eliminate this appropriation entirely in FY 1982 and 1983, would leave us little choice but to make a service adjustment. The other two theoretical options -- raising rates or increasing our productivity targets -- are impractical for this purpose. Tagging this money onto our scheduled rate increase would defeat the inflation-fighting purpose of the proposed cuts. And we already have planned for a 3 percent gross productivity improvement, which will be tough to achieve. As the proponents of the cuts apparently recognize, the only practical alternative for a permanent savings of this size would seem to be to reduce regular mail deliveries from six days to five.

Before we begin any step like this, we want to know more about what the likely effects would be. Existing studies are now out of date. We have formed two task forces to look closely at this question, one to study effects on mail service and the other to look into the labor relations aspects.

Regardless of the outcome of the present budget issues, the Postal Service needs to find ways to continue increasing its productivity.

Productivity improvements in our mail processing function turn upon our ability to automate mail processing. Our electronic mail proposals look in this direction. But the largest boost in the next few years should come from plans based on a nine-digit ZIP Code and optical character reading machinery. Our current schedule calls for expanded, nine-digit codes to be made available to the public for use in February 1981. Use of the longer code would not be mandatory, but should find widespread use because it will improve service.

We have already developed nine-digit codes on a test basis in several areas of the country. Coding teams work in pairs to review geographic and mail volume information. Separate code numbers are assigned to individual block faces, firms, groups of lock boxes, rural routes, buildings, and in some cases building floors.

The purpose of the nine-digit code is to enable mail processing machinery to sort the mail automatically. into finer separations, right down to the carrier who will deliver it. This will eliminate some of the intermediate sorts which are now required. Processing should be quicker, more accurate, and less expensive.

These improvements are made possible by better technology which is already available. A sophisticated Optical Character Reader (OCR) will read the code when mail first enters the postal system. A printer will print a bar code or similar symbol which can be read by less sophisticated machinery at the facility where the delivery unit is located to direct the mail piece to the right delivery carrier.

We believe the nine-digit ZIP Code is the best opportunity available right now for improving mail processing operations.

Revenue Forgone Appropriation

The revenue forgone appropriation request for FY 1981 is $789,108,000. This is about $7 million more than was received for FY 1980.

One purpose of the revenue forgone appropriation is the continued phasing or spreading out of previously approved rate increases for preferred-rate mailings. These cover within-the-county, nonprofit, and classroom publications; not more than 5,000 copies of regular-rate publications sent outside the county; bulk-rate nonprofit third-class material; and library-rate material. The phasing subsidies presently are scheduled to end in 1987.

The second purpose of the appropriation is to cover certain costs which by law the preferred-rate mailings are permanently excused from covering. Unlike the unsubsidized categories, most of these mailings are to be charged only their "attributable" costs, and do not contribute to overhead, so long as the appropriation is provided.

The revenue forgone request also includes $111,208,000 as a reconciliation adjustment, following the practice initiated last year. This substitutes final audited volume figures for the preliminary volume estimates on which revenue forgone requests and appropriations are initially made. The requested adjustment picks up final audits for all years not covered last year, through FY 1978. This multi-year adjustment would enable next year's adjustment request to cover only the FY 1979 audited figures, which will become available during the present calendar year.

Transitional Costs

A third section of the FY 1981 request covers transitional costs for the year, for the continuing unfunded liabilities of the former Post Office Department. The two aspects of this item are workers' compensation based on injuries before July 1, 1971, and unfunded and unused annual leave accrued before the same date. These liabilities for the year amount to $68,109,000, an increase of about $1,500,000 in the workers' compensation amount from last year.

Borrowing Limitation

This year's appropriation language submitted by the President includes a request for new language to limit borrowing by the Postal Service during FY 1981 to no more than $1 billion.

Under present legislative authority, the Postal Service may increase its net borrowing for operating purposes by up to $500 million and that for capital purposes by up to $1-1/2 billion in a fiscal year. (39 U.S.C. 2005(a)).

Initially it did not appear that this limitation would be a practical problem for FY 1981, since we have had no intention of incurring debt obligations during the fiscal year in excess of $1 billion. The planning on which our FY 1981 budget submission was based contemplated no borrowing during the year for either operating or capital purposes. There is a chance that we may borrow for capital purposes, but probably not more than $500 million. Thus, we have regarded the limitation as unnecessary.

The proposed appropriation cuts, however, now place a shadow over our previous planning. With the uncertainties involved, we are no longer able to say for sure that the proposed limitation would not be a burden.

In our view, even if it is enacted this year, the limitation should not become a recurring provision in future postal appropriations legislation. If it were to recur annually, it would in the future impair needed flexibility for prudent refinancing of capital debt, and undercut the ability of the Postal Service to stand on its own financial feet.

This concludes the prepared statement and we will try to answer your questions.

OPENING STATEMENT

Mr. **Bolger**. Accompanying me today are three Senior Assistant Postmasters General, Carl Ulsaker from Employee and Labor Relations, C. Neil Benson from Operations, and Jim Finch from Finance.

As you said, the Postal Service is requesting an appropriation of $1,593,217,000 for fiscal year 1981. This is $83,593,000 less than the amount appropriated for fiscal year 1980.

I am pleased to report that the Postal Service is doing much better than we did in the previous period of double-digit inflation back in 1974. Our net $470 million operating income last year gave us the first year in the black since 1945. Through the first 24 weeks of fiscal year 1980, we had a net income of $130.6 million. During February and March, however, we were back in the red. The cost-of-living clauses in our labor contracts, together with rising energy and other costs, will result in an operating deficit when the final returns are in for the current fiscal year. We presently expect it to be about $593 million.

These new deficits mean that early in calendar year 1981 we will need to put into effect our first general rate adjustment since May, 1978. Keeping rate levels steady that long is a remarkable achievement for the postal system in these tremendously inflationary times.

Our appropriation request this year covers the usual three elements: public service costs, revenue forgone for free and reduced-rate postage, and transitional costs left over from the activities of the former Post Office Department.

PUBLIC SERVICE APPROPRIATION

The public service appropriation authorized for fiscal year 1981 is $736 million. This is the second step down from the $920 million which we received during the 1970's. Present law provides for this appropriation to level off at $460 million beginning in fiscal year 1984, unless the Postal Service determines it is no longer needed.

The public service appropriation is intended as a general supplement to postal revenues in light of the many public services which the Postal Service performs. In receiving the benefits of a universal postal system serving low-volume areas as well as high-volume areas, our customers are not always expected to pay dollar for dollar for the costs of the services they use.

In fiscal year 1972, this authorization covered about 10 percent of the Postal Service budget. For fiscal year 1981 it is less than 3½ percent.

As you know, the administration and the congressional Budget Committees have recommended cuts in this appropriation for fiscal year 1981 and the next 2 years. The size of these cuts, which would eliminate this appropriation entirely in fiscal year 1982 and 1983, would leave us little choice but to make a service adjustment. The other two theoretical options—raising rates or increasing our productivity targets—are impractical for this purpose. Tagging this money onto our scheduled rate increase would defeat the inflation-fight purpose of the proposed cuts. And we already have planned for a 3-percent gross productivity improvement, which will be tough to achieve. As the proponents of the cuts apparently recognize, the only practical alternative for a permanent savings of this size would seem to be to reduce regular mail deliveries from 6 days to 5.

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EFFECT OF REDUCTION IN APPROPRIATION

Senator CHILES. The President in his March budget exercise proposed a $250 million reduction to the Postal Service's public service appropriation for fiscal year 1981, the revised request is therefore $486 million as opposed to $736 million originally requested. What would be the impact on postal services if the President's reduction is sustained by the Congress?

Mr. BOLGER. There are three things we can do with any tax moneys that are to be reduced. One is to increase our prices further, and we are going to increase them in 1981. Another would be to try to absorb it through increased productivity which is a tough task because there is already a 3-percent productivity increase built into our budget recommendations for fiscal year 1981. And the last is to make some adjustment in the level of service we give.

The $250 million that we are talking about is a one-time adjustment, just in fiscal year 1981, without any adjustments in the out years of 1982 and 1983. We would probably try to absorb most of that through further increases in productivity. As I understand the OMB's proposal for the President, $250 million would be cut out of fiscal year 1981 for the public service appropriation and in 1982 and 1983 would be zero. Under those conditions as I see it, we would have to plan to make a service adjustment.

Senator CHILES. The House Budget Committee proposed a total elimination of the public service appropriation and a $100 million reduction in the revenue forgone appropriation. What would be the impact on services and postal rates if the Postal Service was required to sustain a reduction of the magnitude proposed by the House Budget Committee?

Mr. BOLGER. In the first place the $736 million reduction or elimination of the public service subsidy would definitely in my judgment cause a major adjustment in the service. We would have to make a reduction in the number of days of delivery from 6 to 5.

A $100 million reduction in the appropriations of revenue forgone would also be somewhat restrictive. It would not apply to the blind or the library postages as I recall the proposed resolution from the House Budget Committee.

In that case, we will request the Board of Governors to prorate that reduction of appropriation over the rates that the other categories and classes of mails covered by the forgone appropriations other than the library and free mailing for the blind. I don't know exactly what rates would be affected and how at this moment in time.

Senator Chiles, If the Postal Service is faced with a $100 million reduction in the revenue forgone appropriation I think you have answered that, the postal rate subsidy would be prorated.

Mr. BOLGER. Yes; I can give you some examples, if you would like, for the record, of the things that would be affected: second-class mail within county, nonprofit publications and classroom publications; third-class nonprofit bulk rate mailings generally of charitable organizations.

SECOND- AND THIRD-CLASS MAIL

Senator CHILES. You heard Mrs. Rivlin's CBO testimony, which was to the effect that of the ones that she had information on, I think they left out religious organizations because they didn't have the information, but of the other charitable organizations, it would amount to less than 0.2 percent of their net income and she felt it would not have much macro effect on their mailings.

Mr. BOLGER. On each individual organization?

Senator CHILES. Yes.

Mr. BOLGER. I think she is probably right.

Senator CHILES. The Post Office doesn't have any information that would be contrary to that?

Mr. BOLGER. I didn't hear her complete testimony. I left the room. I have reviewed her testimony, and I do not have the information. Jim, do you have anything?

Mr. FINCH. As I understand the study that the CBO staff conducted, they received gross numbers on total income for the organizations, as required by the IRS on an annual basis. We don't have those. We don't have anything in the files that would contradict it.

Senator SCHMITT. Just to follow up on that, do you take a look at what the market will bear in terms of rates before you start to see a downturn in volume?

Mr. BOLGER. Sure.

Senator SCHMITT. I think her statement was based primarily on historical information. Presumably there is some in which there would be a decreased use of the mail.

ELASTICITY OF DEMAND

Mr. FINCH. We used the demand elasticity to the extent we have the information to project what impact a certain level would have on certain types of mailing.

Senator SCHMITT. You are saying based on your understanding of the elasticity in the market that a loss of that subsidy would not noticeably effect the propensity of the mail volumes?

Mr. FINCH. We haven't actually had an opportunity to apply those demand elasticities to those particular small subclasses of mail, for the very reason that the nonprofit rate they pay is derived out of the regular rate, but we do demand elasticities based on our costs to establish the regular rate and back down from that for the subsidy. So we don't have the demand elasticity that handles it, for instance, for a second-class nonprofit publication.

Mr. BOLGER. I think we also should state that this particular type of mailing has been growing at a rapid rate. While the rate of growth may slow, I don't expect to see a downward trend. If this subsidy were eliminated or modified, I wouldn't expect it to turn downward, at least not immediately. If we turn that around, if this appropriation is denied and then we do not increase the nonprofit rates or do not increase those costs and spread this reduction of the revenue forgone over the profitmaking mail classes, we definitely would see a dropping and I think substantially.

Senator SCHMITT. Thank you.

REVENUE FORGONE SHORTFALL

Senator CHILES. The Postal Service last year, for the first time, requested and received an appropriation of $46.7 million for revenue forgone for free and reduced rate mailing representing a shortfall in the 1977 appropriations resulting from underestimates of mail volume.

In explanation of the request submitted for the hearing record last year, the Postal Service said that although the appropriations are insufficient for earlier years, also management considered them forfeited because of the time interval and the amounts involved.

However, your 1981 budget requests a total of $111.2 million for this item going back to fiscal year 1974 through 1978, excluding 1977. Why have you now decided to request reimbursement for the shortfalls occurring before 1977?

Mr. BOLGER. As I understand the current law, Senator, if anybody including myself said that they had the right to forfeit those appropriations, I think they were wrong and I was wrong. So looking at the current law, we are obligated to establish what the volumes were to the best of our ability and make the request for appropriations to cover the difference in our regular rates and the rates that were charged the mailers for those volumes.

Senator CHILES. Isn't it a little unreasonable to apply this new policy retroactively back to 1974?

Mr. BOLGER. I don't think it is unreasonable under the current law. Certainly it is something that we should have done before this. We should not have waited until this time to go back and collect the moneys that were due us. I don't consider it unreasonable to go back under the law as I read it and try to collect.

Senator CHILES. I hope you won't consider it unreasonable if the Congress doesn't decide to give you that money. [Laughter.]

Mr. BOLGER. That is a judgment for the Congress to make as you know.

Mr. FINCH. Of that $111 million, $56.2 million is a reconciliation adjustment for fiscal year 1978. This request reflects the latest official figures available. The $46 million we received last year was for fiscal 1977.

Mr. BOLGER. In other words, you are saying $56 million is the most current.

Senator CHILES. Give us a breakdown for the record of each of the years, 1974 through 1978.

Mr. BOLGER. We would be happy to.

[The information follows:]

REVENUE FORGONE ESTIMATED AMOUNTS APPROPRIATED VERSUS AMOUNTS INDICATED BY ACTUAL VOLUMES

[In millions of dollars]

Category	Appropriations			Accumulative appropriations over or understated (−)
	Phased rates	Continuing	Total	
Fiscal year 1974:				
Total appropriated	291.9	211.7	503.6	
Amount indicated by actual volumes	282.9	227.0	509.9	
Over or understated	9.0	−15.3	−6.3	−6.3
Fiscal year 1975:				
Total appropriated	342.6	272.9	615.5	
Amount indicated by actual volumes	344.9	293.2	638.1	
Over or understated	−2.3	−20.3	−22.6	−28.9
Fiscal year 1976:				
Total appropriated	442.2	282.3	724.5	
Amount indicated by actual volumes	448.2	302.4	750.6	
Over or understated	−6.0	−20.1	−26.1	−55.0
Fiscal year 1977:				
Total appropriated	477.3	314.8	792.1	
Amount indicated by actual volumes	531.0	307.8	838.8	
Over or understated	−53.7	7.0	−46.7	−101.7
Fiscal year 1978:				
Total appropriated	571.5	230.0	801.5	
Amount indicated by actual volumes	543.2	314.5	857.7	
Over or understated	28.3	−84.5	−56.2	−157.9
Total:				
Total appropriated	2,125.5	1,311.7	3,437.2	
Amount indicated by actual volumes	2,150.2	1,444.9	3,595.1	
Over or understated	−24.7	−133.2	−157.9	
Reconciliation adjustment requested (1980 budget)	53.7	−7.0	46.7	
Balance remaining	29.0	−140.2	−111.2	

DEFICITS IN FISCAL YEARS 1980 AND 1981

Senator CHILES. The Postal Service ended fiscal year 1979 with a net income of $470 million, the first surplus in Postal Service history. The Postmaster General stated the Postal Service will meet its commitment to hold postage rates at the current levels until 1981, although a deficit of $593 million is expected in 1980 and a whopping $2.4 billion deficit in 1981.

RATE INCREASE PROPOSAL

I understand that the Postal Service has applied to the Postal Rate Commission for a rate increase and we now see that that is as high as 20 cents. Is that what it looks like it is going to be?

Mr. BOLGER. We filed for a 20 cent letter rate and a number of other rates.

Senator CHILES. What is the postcard rate?

Mr. BOLGER. Thirteen cents, but there are some discounts for volume mailers which will lessen the impact of our business. We are proposing an overall increase of 8.4 percent for parcel post and decreases in some of the nonprofit rates. For regular second class rates there is a 1.9-percent increase which is based on our latest cost studies.

We did meet our commitment and are going to continue to meet our commitment to not increase our rates again until probably March of 1981. We are taking a loss this year of $593 million. We could anticipate, just following the CPI, that loss would have been $1.2 billion. However, we factored into our 1980 fiscal year an increase in productivity of 3 percent to lower that deficit to $593 million.

I think in the public interest we can take the loss in fiscal year 1980 and not contribute to more inflation in this country and keep our rates in line. I think it is a good decision.

FISCAL YEAR 1981 EMPLOYMENT INCREASE

Senator CHILES. The Postal Service employment has been coming down steadily since the Reorganization Act of 1970, but now for the first time in several years, the Postal Service is proposing to increase 1981 employment by 0.6 percent. Why is it necessary to increase employment?

Mr. BOLGER. We are looking at the projection in volume of several billion more pieces of mail. These are work-year estimates, not necessarily additional bodies on the payroll. We have a lot of flexible schedule employees who do not work a full work-week now. These are work-year increases and again not necessarily increases in the payroll.

Senator CHILES. If you reduce service, in effect you would not be needing to add employees?

ELIMINATE 6 DAY DELIVERY

Mr. BOLGER. If we eliminated the 6 day delivery, after 1 full year of implementation it would probably reduce the payroll of the Postal Service somewhere in the neighborhood of 15,000 to 20,000 jobs.

Senator CHILES. That would be done by attrition?

Mr. BOLGER. I suspect so, although there may be areas of the country where attrition isn't available and we might have to resort either to reassignments to other areas of the country, or to some layoff. Layoff is limited because in our principal labor contracts the only people we have privilege to layoff, if we have to other than for cause, are those hired after September 16, 1978.

However, while 60,000 people were hired since September 16, 1978, we couldn't reduce all of the jobs through attrition, since about 19,000 of those hired were letter carriers who would take the greatest impact in the change of service like this. So, I think there is ample room to take care of this through attrition and for the few places where we couldn't, we could probably do it by laying off new hires.

PARCEL POST RATE INCREASE

Senator SCHMITT. Mr. Chairman, I believe in that proposed increase there is an 8.4-percent increase in parcel post rates?

Mr. BOLGER. Yes, sir.

Senator SCHMITT. Presumably you have estimated that would be sufficient to cover parcel post expenses without a cost subsidy?

Mr. BOLGER. Yes, absolutely.

Mr. FINCH. The cost coverage on parcel post is 126 percent. Those rates pay all of the postal costs which are attributable to the parcel post, plus 26 percent over and above that contribution. The contribution to overhead is about $89 million.

Senator SCHMITT. Has the parcel post volume been increasing?

Mr. BOLGER. No; the parcel post volume has been dropping. We are having some new rates introduced in the rate case, interbulk mail area rates, which I think are going to help us recapture the share of the growing parcel market.

I think this is necessary for the Postal Service and for the American public, that we stay healthy in this parcel market. We are making this attempt in this rate structure to do so.

Senator SCHMITT. To keep UPS honest?

Mr. BOLGER. I think it is good. I don't think in the parcel delivery market, where it is so big and it is necessary to serve everyone wherever they are located, that we should subject the people to only one alternative.

NINE-DIGIT ZIP CODE

Senator CHILES. I understand that the Postal Service is continuing to plan for a nine-digit ZIP code and in order for the Postal Service to process nine-digit ZIP code mail, it would require the development of three pieces of equipment—M36 facer cancelers, optical character readers at anywhere from $300,000 to $800,000 apiece, and bar code readers at approximately $100,000 apiece.

We have been told that total capital cost to the Postal Service to process nine-digit ZIP code mail may be over half a billion dollars. What is the status of the Postal Service's proposal for the nine-digit ZIP code?

Mr. BOLGER. We are planning to implement the nine-digit ZIP code in February 1981 and have it fully implemented by 1984.

First of all, the nine-digit ZIP code would not be mandatory for the individual citizen of the country to use, although we would love to have them use it. We hope the business users will use it. It will help us to get to automation faster, help us cut down the mail processing expenses. We will be expending some moneys to buy the equipment after we implement the ZIP code.

Most of it is for scanners, so we can properly sort this mail through automation. We can't do it now. I think the initial expenditures are for facer cancelers. We already have procured these and are in the process of procuring more. But the scanners, your figures on the estimated cost for each one are somewhere in the ballpark although we haven't put out a request for procurement on them yet. We will not go fully on this thing. We will go very slowly in buying the scanners and equipment we need. The outside figure for the total capitalization if we did everything, is around $600 million.

We are not going to authorize that type of money and I am not going to request it of the Board of Governors and Capital Investment Committee. We will go very modestly on it to see how the ZIP code takes.

Senator CHILES. As I understand it, the average person doesn't have to put on the nine ZIP code number?

Mr. BOLGER. That is right.

Senator CHILES. What is the advantage of business doing it? Are they getting a reduced rate or just a quicker service?

Mr. BOLGER. We have established a couple of rate cases, wherein the mailer does certain steps, such as sort first-class mail. We reduce their rates because it avoids costs in the Postal Service. We plan to add another feature to this with the nine-digit ZIP code. If the mail is presorted down to the carrier routes there is a different discount for it. Use of the nine-digit ZIP code would give the mailer an incentive, it would make it attractive for them to use the nine-digit ZIP code.

Senator CHILES. Is the technology proven for the equipment?

Mr. BOLGER. Yes, sir. It has. Unfortunately we had difficulty in procuring it. The American sources have not been as successful as I would like them to be. We have two American companies that are developing some models for us. They look like they are going to be successful. So all of our eggs are not being dropped in one basket like previous attempts. We will try to procure updated equipment. We have about half a dozen scanners that are already in use, and foreign countries are using them now to see how they work. So far they have been reasonably successful.

My plan is still to buy American.

NONFIXED MECHANIZATION COSTS

Senator CHILES. Is the $226 million for nonfixed mechanization in your 1981 budget estimates primarily for the expanded ZIP code equipment?

Mr. BOLGER. Yes.

Senator CHILES. Describe the various types and quantities of mail processing equipment that will be bought. You can give that to us for the record.

Mr. BOLGER. It is basically scanners and numerical readers.

[The information follows:]

NONFIXED MECHANIZATION FISCAL YEAR 1981

[In millions of dollars]

Type of equipment	Quantity	Amount
Multiposition letter sorter machine retrofit kits This program will provide kits to modify MPLSM's to make them capable of four-digit keying required to support the nine-digit ZIP code program.	300	$15.0
Optical character reader (OCR) This program will provide OCR presort equipment capable of reading the expanded ZIP code and printing it in bar code form on the envelope face or subsequent processing on bar code sorters.	130	130.0
M-36 letter mail preparation systems These machines will be compatible with mechanization required to support the nine-digit ZIP code program.	168	17.0
Bar code sorter conversion kits This will provide conversion kits to convert MPLSM's to have 305 pockets (from 277) and two mail transport units with bar code readers to support the OCR presorters and nine-digit ZIP code program.	65	25.0
Bar code sorters—100 pockets This program will provide 100 pocket sorters with bar code readers to support the OCR presorters in the nine-digit ZIP code program.	73	7.5
Subtotal nine-digit ZIP code		194.5
Batch mail processors	20	5.0
Flat sorters	160	17.5
Letter mail preparation improvements		4.0
Regional requirements, conveyors, sack and pouch label machines, cancelling machines, and other mail processing equipment		5.0
Total		226.0

IMPLEMENTATION TARGET DATE

Senator CHILES. Are you going to be able to meet your 1981 implementation target date?

Mr. BOLGER. Yes, sir. I must mention that this is not something we just ventured into without checking it out, particularly with the business mailers and various business associations, and we found general acceptance for this approach—I think we are going to be successful. It won't be easy. It will be very difficult, but I think we will have success.

Senator CHILES. What is the degree of implementation expected in 1980 for your post office volume?

Mr. BOLGER. Basically I don't think it will have any impact on the 1980 budget at all. In fiscal year 1981, it will be slight. We have to design our current rate case to show very little impact through automation, so by the time we get to fiscal year 1984, I would anticipate we will have ample use of the expanded ZIP code, and we will have in place or should have in place the equipment for automation to handle the expanded ZIP code.

COST RECOVERY THROUGH SAVINGS

Senator CHILES. Is the estimated $500 million annual cost savings directly relatable to the systems' cost of $250 million, and therefore the cost would be recovered in the first 6 months after full implementation?

Mr. BOLGER. I am not going to make a committment that we are going to recover it all in 6 months. If everything works and if everything falls into place, that is the way it should work. But, as you know, in programs of this magnitude, things don't always fall in place the way you would like them to. Those are our best estimates.

Senator CHILES. We would like to take advantage of those cost savings. We can cut out $250 million and anticipate the full savings.

PRODUCTIVITY AND PERSONNEL COSTS

Mr. BOLGER. Looking into the out-year, we didn't design our rate case for fiscal year 1981. We built in our rate case productivity improvements close to 3 percent. For fiscal years 1981, 1982, and 1983, I made a determination that we have to get at least a 3-percent increase in productivity each year and part of it is getting this with automation.

Senator CHILES. What is the composition of the $500 million annual savings? Is that primarily personnel costs?

Mr. BOLGER. It is primarily personnel costs. Eighty-six cents of every dollar we expend is for salaries and fringe benefits. If we are going to be successful in reducing our operating costs, we have to eliminate work hours from our payroll.

Senator CHILES. How many employees have you affected and how long will it take through attrition to realize such a reduction in work force?

Mr. BOLGER. I hope the volume in the Postal Service is going to continue to grow. That should help provide the additional revenue needed. It will offset some of the reduction in manpower that we might have to make. But, I think we can do most of it through attrition.

The way this is to be implemented, it will be over a 3-year period, and with proper planning I think we can pick up most of the affected jobs through attrition.

POSTAL RATE COMMISSION FUNDING

Senator CHILES. The Postal Rate Commission, which is a body which has regulatory powers over the U.S. Postal Service, is itself funded by the Postal Service. Doesn't that situation tend to undermine the autonomy of the Postal Rate Commission?

Mr. BOLGER. I haven't seen them suffering from any lack of independence lately. [Laughter.]

Mr. BOLGER. The contrary is true, but I think it is a ludicrous situation. I don't think we should be funding our regulatory body.

Senator CHILES. It would be preferable if the Postal Rate Commission had some independent source of funding?

Mr. BOLGER. Absolutely.

Senator CHILES. I agree.

ELECTRONIC MESSAGE SERVICES

Senator SCHMITT. Mr. Chairman, can I jump in here? As you know, I have some passing interest in electronic mail. I have a list here, Mr. Chairman, you may be scanning it, of services presently proposed by the private sector for electronic message activities. I would also like to include in the record, in addition to that list, some recent descriptions of some of these services.

Senator CHILES. Both of them will be included in the record.

[The information follows:]

SUMMARY TABLE OF INDUSTRY COMMUNICATIONS SERVICES

***ACS/ATT:** Computer based interactive digital communications network, designed for interfirm data exchange. Plans include extensive and flexible message preparation, transmission, and delivery service.

***BDS/SBS:** Rooftop-to-rooftop (satellite) intracompany digital network offering a number of services, one of which is document distribution.

BUREAUFAX/WUI: Commercial international digital facsimile service.

***COMPAK/ITT DTS:** Computer-based interactive digital data communications network.

DATAPOST/TDX Systems: Electronic message service, used by banking and credit-collection firms.

FAXGRAM/Graphnet Systems: Computer-based domestic digital facsimile service.

***INFOCAST/DBC:** Communications network that would utilize a combination of telephone loops, Telenet circuits and broadcast FM radio to deliver letter-type messages.

MAILBOX/Scientific Timesharing: Computer-based "mailbox-type" electronic message service for network subscribers.

MAILGRAM/WU: Electronic message service with input at any WU facility.

ONTYME/Tymnet: Computer-based "mailbox-type" electronic message service for intercompany use.

Q-FAX/RCA Globecom: Commercial international digital facsimile service.

SPEEDFAX/SPCC: Packet-switched domestic facsimile service (has digital as well as analog capability).

***TELEMAIL/Telenet:** Computer-based "mailbox-type" message service that includes access to data banks for network subscribers.

WILCOM/Wiltek: Computer-based "mailbox-type" intercompany and intracompany message collecting and directing service. Correspondence or "mail" may be picked up every 30 minutes via computer polling of customer terminals.

WORLDFAX/ITT Worldcom: International digital facsimile service for lower volume users.

***XTEN/Xerox:** End-to-end digital broadband intracompany communications for document distribution, data communications, and teleconferencing. Utilizes nodal or cellular radio techniques for local distribution in metropolitan areas and satellite links for long-haul transmission.

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*Services not operative as of Jan. 1, 1979, but in various stages of development (trial runs, applications pending, etc.).

BACKGROUND ON SATELLITE BUSINESS SYSTEMS' ROLE IN ELECTRONIC MESSAGE SERVICES

Satellite Business Systems (SBS) is a private company that, beginning in January 1981, will provide high-capacity, all-digital communications services via satellite to a variety of large organizations in the United States. SBS was established in December 1975 as a partnership formed by Aetna Life & Casualty, COMSAT, and IBM Corporation.

SBS will provide high speed communications links via satellite for business and government customers, which will make it possible to communicate documents such as letters, contracts or drawings at speeds 120 times greater than the most common facsimile devices in use today. The image quality will compare favorably with original typewritten information. For demonstration purposes SBS is now installing two prototype high-speed computerized copiers which can print better than 3,600 pages an hour (or faster than one page per second) communicated via satellite. SBS customers can connect such advanced terminals to the high capacity SBS satellite communications system and operate their document distribution system at a data capacity of up to 1.5 million bits a second (156 times greater than ordinary telephone lines). Such systems will lead to fast, long-distance, high-volume transmission of documents. Using advanced high-speed document communications terminals, SBS customers may ultimately replace conventional internal mail and messaging systems.

The SBS customer will also be able to integrate its diverse communications requirements (for voice, data, facsimile, etc.) into a single, fully switched, centrally managed private network and to implement new communications applications not previously practical or possible such as video teleconferencing, high-speed computer-to-computer networking, and high-speed electronic mail.

Graphnet offers FAX GRAM service which is available from any type of communications terminal (such as Telex, TWX, facsimile, word processor, CRT, computer or computer terminal) to any addressee location in the U.S. Delivery is available by electronic means or by telephone, mail or messenger anywhere in the continental United States.

GTE Telenet Moves Into Electronic Mail

Special to The New York Times

WASHINGTON, April 2 — GTE Telenet, a subsidiary of the General Telephone and Electronics Corporation, plans to offer a new electronic mail service called Telemail beginning July 14, the company announced today.

GTE Telenet, based in Vienna, Va., specializes in the operation of packet-switching networks that provide communications services between various types of computers and data terminals.

The new service will enable subscribers to gain access to GTE Telenet's nationwide network with a video display terminal and to send messages to other subscribers or to nonsubscribers by connecting with Western Union. Western Union provides access to Telex and TWX subscribers, as well as to the Postal Service's Mailgram system.

Telemail marks an early entry into the electronic-mail industry , which may soon have the United States Postal Service as a major participant.

Charges for the GTE Telenet system will be 22 cents a minute in prime time and 5 cents a minute at night or on weekends. A 50 percent discount will be offered to high-volume users.

John K. Peters, vice president of advanced network services at GTE Telenet, estimates that there are more than 1.5 million computerized terminals and other types of equipment, such as word-processors, that can connect with the Telemail system.

[From Computerland, March 24, 1980]

Clustered Terminal System Also Bows

Tymnet's Packet-Switched EMS Leads Debuts

By Brad Schultz
CW Staff

MIAMI BEACH, Fla. — An electronic message service (EMS) offering a direct link between data and facsimile terminals, a clustered terminal system priced at 25% less than its IBM counterpart and a 130 packet/sec communications processor highlighted the slate of products unveiled at Interface '80 here last week.

Tymnet, Inc. announced Ontyme II, an EMS that allows direct transmission of data from Ascii terminals to "virtually any" facsimile unit for hard-copy representation. Written in Pascal, the software service will be available through the Tymnet packet network starting June 1.

Ontyme II supports nearly all makes and models of Ascii terminals in any combination, Tymnet claimed, including IBM 3270-compatible devices, dial-in, dial-out and TWX units.

Ascii-to-Fax Translation

At the heart of Ontyme II is Compression Labs, Inc.'s Ascii-to-Facsimile Translator (AFT), which supports 4- to 6 min/page (CCITT Group 1) and 2- to 3 min/page (Group 2) facsimile units. AFT accepts messages coded in Ascii, Baudot, Ebcdic and other character sets that are prefaced by a message header containing the destination unit's telephone number, a Compression Labs spokesman said.

AFT automatically dials the receiver's telephone number, accepts Touch-Tone operator commands and then converts the message text to facsimile-compatible output, he explained. The translator also transmits partial and multiple-page documents automatically, preventing unnecessary telephone tie-ups, he added.

Terminals can communicate with an AFT module via an RS-232C interface at speeds up to 9,600 bit/sec. Ontyme II users can add a facsimile-to-facsimile message-switching capability to Ontyme II with Compression Labs' previously announced Facsimile Compressor (Fax-Comp), the spokesman noted.

By reducing the bandwidth needed to transfer messages, Fax-Comp can trim the cost of using Ontyme II.

As an adjunct to conventional DP, Ontyme II allows the user to route messages through a network without knowing whether receiver stations are terminals or facsimile devices, a Tymnet spokesman said.

Tymnet had not established a price for Ontyme II at press time, but said it expects to file a tariff with the Federal Communications Commission soon.

Terminals Emulate 3270

Interface attendees also saw Racal-Milgo, Inc. unwrap its Model 4270 clustered terminal system series, which emulates IBM's 3270 line of CRT terminals. The series includes a 4274 system controller; 4278 CRT terminal and two printer models.

Under IBM's Bisynchronous Communications, Synchronous Data Link Control or Systems Network Architecture protocols, the 4274 and 4278 match the functions available with IBM's 3274 control unit and 3278-2 CRT terminal, respectively, but cost about 25% less, a Racal-Milgo spokesman claimed.

The 4270 series runs in the 2,000- to 9,600 bit/sec range. Each 4274 drives control functions through a 16-bit microprocessor and I/O functions through additional 8-bit micros; the controller supports up to 32 CRT terminals and printers.

With a swivel monitor, the 4278 CRT terminal displays 24 80-char rows on a 15-in. screen. Users can place the 4278, a 160 char./sec serial printer and a 200 line/min printer up to 5,000 feet from the controlling 4274, the spokesman stated.

A 4274 with four 4278s and the serial printer costs $27,190 or leases for one, two and five years for $696/mo, $560/mo. and $488/mo, respectively.

Packet-switch communications processors were unveiled at Interface '80 by BBN Computer Corp. (see story on Page 35). The processors handle 130 packet/sec.

Among other products introduced at Interface '80, Univac's Minicomputer Operations gave each member of its V77-600 and V77-800 processor series links to its Distributed Communications Architecture (DCA). For $3,000, users can now run multiple lines from DCA to each processor.

The same enhancement gives compatibility with Datapac and other public data networks, the vendor noted.

Univac also presented the Global Resource Access Module (Gram), a software interface to DCA that reportedly allows applications to be developed independent of communications protocols. Gram costs $1,000.

A third product from the Blue Bell, Pa.-based vendor, the Model 1004 LPH module, allows the non-DCA user to implement remote batch tasks between a V77-600 or 800 and Univac's 90 or 1100 systems. It costs $3,000.

Another introduction at the conference was NCR Corp.'s Tran-Quest software, which the vendor said will allow non-DP personnel to use computer-stored data bases. Incorporating a data dictionary, data manager and query processor, Tran-Quest runs with NCR's version of Cincom Systems, Inc.'s Total data base management system and with the firm's V-8000 computer systems.

The data dictionary defines and documents all elements of the user's host system including hardware and operating systems.

The one-time license fee for Tran-Quest is $13,000. Its monthly license fee is $325.

ELECTRONIC MESSAGE SERVICES

Senator SCHMITT. Although the list is not complete, it describes 16 private sector offerings of electronic message services. Mr. Bolger, would you agree that some of these offerings are very similar to what the Postal Service has in mind with ECOM and the plan following on electronic message service system?

Mr. BOLGER. I think they are the same type of service being offered by the private sector. The difference is that the hard copy is being delivered by a third party, while we have a monopoly on delivering that mail at the present time. I think that monopoly is still very much necessary in this country because we happen to be the only people who are ready and willing to serve everyone nationwide.

Senator SCHMITT. That hasn't been the issue I raised—the third party hard copy delivery. What special unmet needs will the Postal Service be needing that will require, as I understand it, almost $1 billion increase, by 1990?

Mr. BOLGER. Basically, Senator, we are trying to identify what our role should be in this. We haven't seen anybody yet offering any nationwide service to serve everyone. Our major interest is trying to use the electronic technology, to transfer the messages from point to point so we can lessen the processing costs and improve our service. I think there is a likelihood it will reduce our processing costs.

Senator SCHMITT. Your goal is some kind of a universal service in anticipation that the private sector would not offer such, in aggregate?

Mr. BOLGER. I think it is a logical thing for the Postal Service which has the unique advantage of having the facilities all over our Nation, including the most remote islands, Alaska, Hawaii, and Puerto Rico. I think we should be working—that is what we are trying to do, work in partnership with the private sector to find out what our role should be and provide the service that the American people need.

I don't see the Postal Service ever becoming a telecommunications common carrier. I just don't think that is our role at all. I certainly don't think the public, the corporate ratepayers of the conventional Postal Service would pave the way for any new inventions in electronics that we would be involved in, nor do I see the taxpayers subsidizing this type of service.

But I do think we are going to be in the position to try things in partnership with clients.

Senator SCHMITT. Isn't it a little dangerous, if I understand you, to hang your hat on the fact that you have currently hard copy delivery monopoly when already there are satellite services proposing direct satellite to home broadcast systems that potentially are carriers of digitized, secure, electronic mail?

Mr. BOLGER. We already have a terminal that takes it, in the form of the person with the blue uniform.

Senator SCHMITT. I understand it will be cheaper to send it directly there from origin through a satellite, onto the home TV set and out onto the hard copy?

Mr. BOLGER. Believe me when we get to the point where it is terminal to the terminal, terminal to the home, I don't see the Postal Service playing a role in that, not in this country.

Senator SCHMITT. You also indicate that you wouldn't see undertaking any service that would require a subsidy? If you did that, it would not be appropriate?

Mr. BOLGER. As we venture into electronics, we have plans only to set up a separate organization, and if we were in the private sector, I would be talking about setting up a separate profit center to involve ourselves in whatever role we have to play.

Yes, we are using some funds today experimentally. They are very limited funds. Whether it is ECOM, or whatever we are going into, I would set it up as a separate organization, fund it separately, and the initial funding might be for capital equipment. I would recommend a process where we have no impact on the private payers and no impact on the taxpayers.

DISPUTE WITH THE FCC

Senator SCHMITT. On February 25 of this year, the Postal Service notified the Federal Communications Commission that it intended to proceed with Intelpost without using the services of the U.S. International Record Carriers because of an unresolved tariff dispute at the FCC. The Postal Service plans to utilize the facilities of Canada's Telegol at this time, as I understand it.

I would ask that a copy of the Postal Service letter to the FCC be included in the record at this point, Mr. Chairman.

[The information follows:]

Letter From Charles R. Braun, Assistant General Counsel, Special Projects Division, United States Postal Service

February 25, 1980

Mr. William J. Tricarico
Secretary
Federal Communications Commission
Washington, D. C. 20554

Re: 1980 INTELPOST Service Field Trials

Dear Mr. Tricarico:

This is to advise that the world-wide INTELPOST service network has been redesigned so that the service can soon be publicly offered without international satellite and cable circuitry provided by American entities. The possibility of such network redesign was indicated in pleadings which we filed with the Commission last year. 1/

The INTELPOST service field trial network which had been scheduled to start operations last year had been designed to operate under the control of a single central postal computer located in the United States. World-wide INTELPOST service field trials were thus entirely dependent upon the provision of international satellite and cable half-circuitry by U. S. international record carriers. When the Postal Service was unable last year to obtain the circuitry it needed for such tests from these carriers, the experimental development of INTELPOST service was temporarily interrupted on a world-wide basis.

In recent months, however, Canada Post, acting in cooperation with Canada's CNCP and Teleglobe, has agreed, with the United States Postal Service and its INTELPOST service partners abroad, to join the INTELPOST network, and to install and operate postal computer facilities duplicating those already installed in the United States. We anticipate that the installation of such postal computer facilities in Canada will be completed by March or April. As a consequence, any half-circuit telecommunications links needed between North America and Europe for the world-wide INTELPOST network can be provided by Teleglobe; Asian postal administrations served by trans-Pacific communications satellites and cables can be linked to European postal administrations served by trans-Atlantic satellites and cables via Canadian land lines; and the United States Postal Service can initiate its participation in the INTELPOST network via domestic terrestrial circuits or regular postal channels between the United States and Canada.

We further anticipate that a decision will be made next month to modify one or more INTELPOST computer facilities in Europe, so that direct telecommunications links can be established between European postal administrations, between postal administrations in Europe and the Far East, and between postal administrations in Europe and South America. If such a European decision is made in March, we anticipate that the necessary software modifications can be implemented in Europe well before the end of this year.

The Postal Service continues to prefer that U. S. international record carriers provide international half-circuits for the forthcoming INTELPOST service field trials, and has accordingly continued to retain at its expense leased postal

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1/ TRT Transmittal No. S67, RCA Transmittal No. 4522, Application of United States Postal Service for Review by Commission, November 13, 1979, pages 3 and 9; C.C. Docket No. 79-266, Comments of the United States Postal Service, November 30, 1979, page 4.

computer facilities which would be unnecessary if these carriers do not participate. The Postal Service sought the half-circuit services of these carriers for these field trials in May of last year, following open, competitive procurement procedures. Notwithstanding that the procurement was open to all, one IRC altogether refused without explanation to submit a proposal, and another IRC's submission was non-responsive. The circuitry contracts which the Postal Service awarded in July with the two IRC's then willing to agree to provide such services have spawned two tariff proceedings now pending before this Commission, in which tariffs published by one or both of the IRC's awarded contracts by the Postal Service are contested by one or both of the IRC's who did not offer their half-circuit services to the Postal Service last July. 2/

As the matter now stands, unless the Commission acts affirmatively to resolve or help resolve the inter-IRC tariff disputes now pending before it concerning the international half-circuitry in issue, INTELPOST service will be instituted on a field trial basis in the near future without any international circuitry provided by any American entity.

The Postal Service is willing to meet with representatives of interested parties to discuss ways of resolving the present tariff impasse, if they believe that our presence and participation might be helpful. The present inability of any of the IRC's to provide half-circuitry services to the Postal Service, however, results not from any unwillingness of the Postal Service to purchase the services, but from tariffs filed with this Commission, from interpretations of such tariffs by certain carriers and the Commission's staff, and from litigation by carriers against tariff amendments intended to remove perceived tariff obstacles. These are matters of tariff administration which, while ultimately subject to judicial review, are largely within the control of the Commission and the carriers it regulates, and outside the control of potential customers for the carriers' services. If the Commission wants the IRC's it regulates to participate in the forthcoming INTELPOST service field trials, and if they want to do so, it is up to them to help find a way of making IRC services available for the INTELPOST field trials on a timely basis.

Sincerely,

Charles R. Braun

Charles R. Braun
Assistant General Counsel
Special Projects Division

2/ TRT and RCA Transmittal Nos. 867 and 4522, rejected by Chief, Common Carrier Bureau, October 12, 1979, applications by RCA, TRT, and USPS for review by this Commission pending and ripe for review; RCA Transmittal No. 4575, effective date April 13, 1980, petition to reject or suspend filed by WUI on February 8, 1980; oppositions by RCA and USPS filed on February 19, 1980.

INTERNATIONAL ELECTRONIC MESSAGE TRANSMISSION

Mr. BOLGER. We initiated this proposal with several foreign governments, particularly Western European nations. I think it is kind of a sad state of affairs that because of some regulatory hangup we might not be able to participate directly in it. It is a sad state of affairs when an independent agency of the U.S. Government, the Postal Service, initiated this improvement in receipt and dispatch of communications between and among countries, may not have the opportunity to participate in it unless we go through a foreign source. I think it is too bad.

INTELPOST-SIMILARITY TO PRIVATE SECTOR

Senator SCHMITT. I think it is too bad, too. It is also my understanding that the Intelpost system is nearly identical with the private sector offerings of RCA and I.T.&T. Do you agree with that?

Mr. BOLGER. I think they are similar. However, I think we have the uniqueness that they do not have. We are able to service every place in any offering we make. Again, we want the telecommunications part of our activity to be through the private sector. We do not need to set up our own satellites or our own telecommunications system.

I think, particularly in the international field, it is an effort we ought to be trying. We never did propose to set up this service without coming back to it. We initially put it up for field trials and a 1-year demonstration after that. We haven't gotten beyond Great Britain and this country. We haven't even gotten to the field trials because of the regulatory hangup. I think it is something that ought to be addressed and the answer should come up or down. We ought to know where we are going.

Senator SCHMITT. Isn't part of the problem that the private sector may have and that you feel you may not have, is dealing with the in-country postal services since they are all nationalized services?

Mr. BOLGER. Postal and telecommunications services of various companies have had a natural affinity to deal with the Government agency. I think we have a closer working relationship with them.

Senator SCHMITT. Isn't that partly because the State Department has not assisted other carriers in developing this similar relationship?

Mr. BOLGER. I don't know about that. I have had difficulty with our arrangements with the State Department.

Senator SCHMITT. Is time critical in this that you must proceed without the U.S. carriers?

Mr. BOLGER. I would prefer not to proceed without the U.S. record carriers. I would hope the FCC would see their way clear to take care of the regulatory hangups and get them out of the way so we can proceed.

CONGRESSIONAL CIRCUMVENTION

Senator SCHMITT. Should the Congress proceed legislatively this year in order to circumvent the FCC's activities?

Mr. BOLGER. I would be in favor of expediting our entry into this system. If it is going to take legislation to do it, I would say the sooner the better.

Senator Schmitt. Have you made any proposals of such legislative remedy?

Mr. Bolger. No.

INTELPOST FIELD TRIALS

Senator Schmitt. Intelpost is still described as experimental but now you talk about field trials. What is the field trial, using actual mail?

Mr. Bolger. The field trials are conducted such as the one between London, Washington, and New York. We have been using dummy messages up to this point, just exchanging information between the two dummy services. Beyond that, I would expect that we will get into field trials by customers who want to send their messages commercially.

We are looking at field trials that will last probably not more than about 11 or 12 months. One of the things which nobody really knows, despite international as well as domestic efforts along this line, is whether or not there is a market for this type of service.

One of the things I looked at in Intelpost is the low investment operation to see if there was a market for this type of service.

Senator Schmitt. These people certainly seem to think there is a market development.

Mr. Bolger. They seem to.

CONGRESSIONAL DECISION

Senator Schmitt. There is an awful lot of investment going into it. Last September during the debate on H.R. 4393, the issue of postal involvement in the electronic message services came up as you recall on the floor of the Senate. Senators Glenn, Cannon, and I agreed in colloquy that the basic policy decision on the Postal Service involvement should be made by the Congress.

Senator Cannon concluded that "Clearly the Postal Service is on notice that it should not move in this area without a clear policy statement by the Congress." In 1978, you assured me in the Communications Subcommittee hearings that if "we get into that type of thing we would come back to the Congress of the United States and have a discussion of this before we venture into that type of activity." Yet, the Board of Governors recently recommended that ECOM be permanent rather than experimental. You talked about field trials, you slipped there a moment ago and called it a demonstration—the wheels seem to be turning.

You are proceeding with Intelpost and think it is critical that you proceed and even that you go without the International Record Carrier of the United States. Do you think these facts are consistent with your commitment to come to the Congress for clear authorization?

Mr. Bolger. I think so. We are in no different position than we were at the time that colloquy in the Senate took place. We were then saying that our first effort was to go in partnership with Western Union in the case that was pending then before the Postal Rate Commission to get the ECOM service started.

About 15 months into that effort we were going out with competitive bidding to see if any carriers other than Western Union, were interested in going into a further expansion of the ECOM service at that time.

Senator SCHMITT. Why do I keep having this feeling that you are never going to come back to the Congress until it is a fait accompli?

Mr. BOLGER. I don't know why you have that feeling. I think the whole thrust is the Postal Service's involvement in the use of electronic transmission of messages—I think it has to be addressed eventually with some type of change in the Communications Act of 1934.

I think the Postal Service evolving into electronic communications has to be addressed by proper legislation.

ECOM TO SUBSIDIZE OTHER ACTIVITIES

Senator SCHMITT. Do you see this as a way of subsidizing the other activities of the Postal Service?

Mr. BOLGER. No, sir. I do not. I see it as a way to allow us to keep our volumes up. The use of electronic transmission services will keep our costs down and generate a great deal of volume. We are talking about a lot of mail that still has to be delivered.

I think it will be one way to help us keep our costs in line so we will not have to increase the rates inordinately for other services. If we are not allowed to participate in the use of that technology I think what will be left will be a very expensive postal service.

It will have to be paid for by very high rates or the taxpayers supporting the Postal Service by use of subsidy.

Senator SCHMITT. If I look out 25 years and compare it with the experience we have had in a variety of information systems as we have exploded into the information age, I just frankly don't see why there are any inherent barriers to all mail except packages being transmitted electronically and transmitted at very low rates.

Certainly I don't think we should do anything to preclude that happening. The real question is how do we transition from our present dependency on hand delivery without undue impact on those employees and persons and business dependent on hand delivery at this time, to a time when a much more economical environment exists. It has happened now with cable television as you can see, in combination with over-the-air television and even voice services, starting to eliminate all barriers to information flow.

So, anything you want to put on wires or over-the-air waves you are going to be able to do. Aren't we running a risk with the Postal Service moving into this of continuing a Federal or governmental involvement in an area where there is no need for them to be involved 25 or even 10 years from now?

CHECKLESS SOCIETY

Mr. BOLGER. If we had acted on the projections made about 20 years ago, which estimated that by 1980 we would have a checkless society, the Postal Service wouldn't have the mechanization and facilities needed to handle the very large volume of mail we have today.

I have the same feeling you do, that some of the breakthroughs are going to come along in 25, 30, 35 years. I just don't agree it is going to have that type of impact on all of the mail volume. I don't know for sure, but I am not going to take the chance of the Postal Service being left out in the cold.

We have to keep involved in order to see what use we can make of all of these technologies. If the private sector provided all of the services, both conventional, and electronic, my own personal feeling is that they would not provide a universal service, with universal rates.

ELECTRONIC MAIL SUBSIDY

Senator SCHMITT. You want electronic mail without subsidy which tells me you can believe it can carry its own weight and that means the private sector will be there. And they are there right now.

Mr. BOLGER. I want to use the technology of electronics to see if we can reduce Postal Service costs in the processing and handling of mail and improve the efficiency of the transmission of messages. I am trying to attempt to do this by partnership in the private sector. I wouldn't view this as anything different than not having run the Postal Service's own airlines. When the airlines were developed by the private sector, we decided to move the mail by air through the airlines.

I agree with the use of telecommunications in partnership arrangement with the private sector. How that is going to unfold, I really don't know. I am not going to take a chance while I have this job of not participating in it. I want to make sure the Postal Service role is properly defined.

Senator SCHMITT. Did the Postal Service buy its own airplanes when it began to experiment with airmail?

Mr. BOLGER. No. But we made an attempt to use the military if you will recall in the early 1920's, and we found out that wasn't the way to do it. But, the Postal Service appropriations really subsidized the various airlines in the early years of commercial aviation in this country.

Senator SCHMITT. But we see that probably isn't necessary today with the electronic information services.

Mr. BOLGER. I don't think we are quite sure.

Senator SCHMITT. This list tells me we are there. This is not the list you would have seen in the early days of airmail, but it is an explosion. I don't need to pursue it any further.

Mr. BOLGER. I want to repeat one statement because I think it is important so we can clear the record. Once we get to generation three, using terminal to terminal, terminals connected to the television set in the house, I really don't see a role for the Postal Service. I don't know where all that is going. I don't think anybody really does.

Senator SCHMITT. I think it is safe to say that things are going to be very different 10 or 20 years from now. Just because it hasn't happened yet in message services doesn't mean it isn't happening in other kinds of information services. You know as well as I do it is happening. I think we have to make sure that we don't preclude the development of a more economical, more competitive service than by the activities of the Postal Service in this, whether you call them R. & D. or field service or field tests or demonstration or what have you.

That is what I am afraid of, that we will preclude these other things from happening.

Mr. BOLGER. If any Government agency or the Government as a whole tries to preclude that process, I think we would all be pretty stupid.

Senator SCHMITT. There is some thinking that that is what you are trying to do.

Mr. BOLGER. No; we are not.

OPERATION ALERT PROGRAM

Senator CHILES. Last year when the Postal Service testified before the subcommittee, we discussed the operation alert program that is undertaken by some post offices across the Nation. Essentially, the program operates by the letter carriers keeping a special watch on mail delivery boxes marked with a bright red or orange sticker.

If the mail is not picked up, the Postal Service notifies the participating group or local agency. What has the Service done over the last year to encourage such programs as this?

Mr. BOLGER. On the local and regional level, I can offer something for the record, examples of the types of instructions we have given.

We are very much in favor of this being done. We have done everything to encourage it and nothing to discourage it.

Senator CHILES. If you would provide that for the record, I would like to see it.

[CLERK'S NOTE.—The requested information is printed below in the questions and answers supplied under the heading elderly alert program.]

POLITICAL MAILINGS SUBSIDY

Senator CHILES. The Congress provided the Postal Service with approximately $4 million in 1980 for subsidies for political mailings. The committee's view is once this level is reached the Postal Service should consider it to be a failure of appropriations and adjust the rates correspondingly. Is that the Postal Service's understanding?

Mr. BOLGER. It is.

Senator CHILES. How much has the Postal Service expended this year to date for subsidies for political mailings?

Mr. BOLGER. A little over $1 million. We will supply it exactly for the record.

[CLERK'S NOTE.—The answer is provided by Mr. Finch below.]

Senator CHILES. What is the projection?

Mr. BOLGER. We are still projecting around $24 or $28 million.

Senator CHILES. So you will reach it?

Mr. BOLGER. I think we will reach it. Mr. Finch has some statistics prepared on that.

Mr. FINCH. Yes, sir. You will recall our request last year was for $24 million. That was based on an estimate of 475 million pieces of political mail. So far this fiscal year, we have processed 5.2 million pieces with a little over $1 million of that as subsidy.

I would be happy to submit for the record some testimony entered in one of our prior rate cases by a joint entry from the Republican and Democratic National Committees where they said in election year 1972, their political mailings were between 300 and 400 million pieces. I think it is on target. Obviously there is no way to know.

It is not uncommon in a Presidential election year to see multiple mailings and piece mailings.

SUSAN B. ANTHONY COIN PROMOTION

Senator CHILES. I understand the Postal Service has cooperated with the Bureau of the Mint over the last year in attempting to promote the use of Susan B. Anthony coins. A large amount of posters have been placed in the post offices around the country claiming the coin to be the dollar of the future. It seems to be a very futuristic poster.

When did this promotional effort begin and who has paid for it?

Mr. BOLGER. It started in February of this year and the Treasury Department paid for the promotion. When a Federal agency requests us to cooperate in a nationwide program we do so.

Senator CHILES. Now that the Treasury Department stopped promotion of the coin, is the Postal Service's promotional effort——

Mr. BOLGER. Actually we are still participating in this. We have the coin available through our post offices. It is not forced on anybody. If anybody refuses to take the coin, we give him or her the paper dollar. We put 15 million coins into circulation.

Senator CHILES. I think the remainder of the questions we have we can ask you to answer for the record. We thank you for your appearance.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

VOLUME ESTIMATES

Question: Your justification statement says that the primary variable in calculating the amount of revenue forgone is the estimation of mail volume and that mail volumes were audited by an independent, certified public accounting firm. However, we understand that the public accountant's reports had serious disclaimers about the accuracy and reliability of the volume statistics and cost allocations. They reported a low level of confidence particularly in the accuracy of some of the free and reduced rate mail classifications. What confidence do you have in the accuracy of these final mail volume figures? Could not the probable error rates more than offset the volume differences on which your reimbursements are based?

Answer: We use a sampling system as the only feasible way to measure mail volume, revenue and costs without excessive expense and delay to the mails. We do not agree that there are serious disclaimers about the accuracy and reliability of our data. As with any sampling system, there are measures of statistical precision and levels of confidence given. Two of the preferred rate categories were cited in the most recent audit as possibly in error by as much as 10 percent or greater at an 80 percent confidence level. Those categories are library-rate fourth class and free matter for the blind, both of which embrace relatively small volumes. It should be borne in mind that a sampling system designed to achieve great accuracy for the smallest category will be expensive for all categories of mail. Moreover, whatever error there may be is just as likely to be a plus as a minus. In summary, we believe the data collection systems we employ fairly present information using prudently designed sampling techniques.

PLACING A CAP ON POSTAL SERVICE WAGES

Question: Last year we talked about the fact that the average salary for postal workers had increased from $7,594 in FY 1970 to $14,747, or a growth rate of 94%. In contrast, the average basic pay for white-collar employees increased only 47% during the same period. I understand that the average salary of postal workers is now approximately $18,000 a year. When do current Postal Service contracts expire?

Answer: July, 1981.

Question: As you probably know, the general provisions of the appropriations bill for Treasury, Postal Service, and General Government include a pay cap for blue collar workers requiring that their annual pay adjustments do not exceed the adjustment provided to white collar workers. What would your reaction be if this cap were extruded to Postal Service workers as well?

Answer: The Postal Reorganization Act granted full collective bargaining rights to employees of the Postal Service including the right to bargain collectively for wages, hours and working conditions; and requires binding arbitration to settle any disputes which cannot be settled by the parties. Since 1970, salaries for Postal workers have been established through this process. To impose a cap on Postal salaries would require amendments to the law and would most likely result in disruption among the Postal Service work force. For these reasons my reaction must be negative although I do favor, and have so stated, a cap on the COLA provisions of our agreements if this can be accomplished through the collective bargaining process.

Question: As a matter of equity, why should Postal Service workers receive larger annual pay adjustments than other Government workers?

Answer: In 1970, the fact that Postal workers had very little upward mobility compared to other Government workers under the General Schedule appears to have been a factor influencing the Congress to grant a larger increase to Postal workers than to other Government workers. Limited upward mobility of bargaining unit employees in the Postal Service is still a significant factor.

The Postal Reorganization Act granted full collective bargaining rights to employees of the Postal Service and mandated that the Postal Service establish and maintain compensation and benefits of all officers and employees on a standard of comparability to the compensation and benefits paid for comparable levels of work in the private sector of the economy.

Question: I understand that for every 1% that Postal Service worker pay increases are held down the Postal Service would save over $100 million dollars.

Answer: This statement is correct.

Question: What percentage increases were included in the current contract?

Answer: The 1978 three year Agreement with the NALC, APWU, and the Mailhandlers provided for general increases of 9.3%, or 3% per year compounded plus uncapped COLA. Including COLA, the first year increase totaled 7.6%. Second and third year increases are dependent on the level of inflation but appear to be less than increases granted in other major collective bargaining agreements in the private sector.

The 1978 Agreement with the rural carriers provided for general increases of 2% the first year, 3% the second year, and 5% the third year plus a capped cost of living allowance. Total increases including COLA are 4.3% the first year, 6.3% the second year, and 8.7% the third year. The increases provided for in the Agreement are considerably below similar settlements in the private sector.

ELDERLY ALERT PROGRAM FOR THE ELDERLY

Question: Last year when the Postal Service testified before this Subcommittee we discussed the "Elderly Alert" or "Operation Alert" program that is undertaken by some post offices across the nation. Essentially, the program operates by letter carriers keeping a special watch on mail delivery boxes marked with a bright red or orange sticker given to customers who participate in the program and if the mail is not picked up the Postal Service notifies the participating civic group or local agency.

What has the Postal Service done over the last year to encourage such programs at the local level?

(The material follows.)

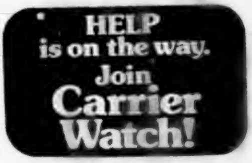
[From the Central Regional Bulletin, Oct. 28, 1977]

Newsy Notes From The Regional Postmaster General:

CARRIERS JOIN COMMUNITY 'WATCHES' OVER SAFETY OF AGED

I can't think of a better way to introduce the project under discussion this week than to ask you to read this letter recently received from a Chicago postal employee. The writer is Stanley A. Kislowski, a carrier at the Irving Park Station.

"I am the regular carrier on Route #13," writes Mr. Kislowski, "for the past 29 years. Today I started out just like every day, but something happened at the end of my route.



"Mr. Huber (a resident on the route) who is 84 years old and I have known him for 29 years—he didn't answer when I rang the bell, so I went around to the back door, but it was locked, so I had a feeling something was wrong. So I went to next door to get a neighbor, and we both went to the back basement door and both went upstairs to the kitchen and found that Mr. Huber had had a stroke and was lying on the floor.

"I put a pillow under his head and told the neighbor to telephone '911'. An ambulance came and took Mr. Huber to the hospital. I called his daughter in Wisconsin, and telephoned my supervisor and reported to him. Then I locked the house up and went back to the post office."

Such concern by a carrier has been a trademark of the U.S. Mail throughout its long history. Scarcely an issue of this Regional Bulletin comes out without a report of a carrier who cared about the people to whom mail is delivered.

All postal people can share in the pride and gratification of this reputation for looking after the welfare of another human being.

And that's why it is particularly pleasant for me to report that the Chicago post office, the largest in our region, has just joined in a cooperative program with Branch 11 of the National Association of Letter Carriers and the City of Chicago to keep a watchful eye out for senior citizens and handicapped persons who may have had an accident in their homes and need help.

Called "Carrier Watch," the program invites elderly or handicapped mail customers to register with the Mayor's Office, giving their names, addresses, telephone numbers and the names of someone to contact in event of an emergency.

Once registered, they receive a decal to be placed inside the mail box where it can be seen only by the letter carrier. This alerts the carrier to watch for an accumulation of mail. If it hasn't been removed for two days (or longer if the carrier is familiar with the customer's habits), the carrier notifies his or her supervisor, who alerts the Mayor's Office to contact the individual and, if necessary, send help.

As a start, the Chicago program will be in effect in three areas of the city, where about 61,000 residents age 60 and over will be eligible to participate. In announcing the program, Chicago Mayor Michael Bilandic said it was hoped it could be expanded to cover the entire city within six months.

Special announcements, in Spanish as well as English, have been prepared by the city to inform the public about "Carrier Watch," and invite those eligible to sign up. "Cartero en Guardia" is how Carrier Watch translates into Spanish.

In various similar forms, this program has been expanded throughout the country. Known as "Operation Alert," it had its beginnings in the Bronx in New York, and has since been activated throughout all that city's boroughs, according to a recent account in Postal Life.

In the Central Region, post offices in Galesburg, IL and Ann Arbor, MI have joined in cooperative agreements in their respective communities to provide a friendly and reassuring watch over those whose possible need for aid could be signaled by their inability to remove the mail from the box.

We wish the Chicago "Carrier Watch" well. It's worth keeping an eye on.

John

[From the Central Regional Bulletin, May 18, 1979]

MUSKEGON CARRIERS ON ALERT FOR ELDERLY

The Muskegon, Mich. post office has joined with Senior Services of Muskegon, Inc., The United Way, and the Muskegon Police Department to establish an early alert emergency program for senior citizens.

Muskegon is the fourth central region post office to formally join a community program to watch out for elderly people. Others with similar programs reported are Ann Arbor, Mich., Chicago, Ill., and Galesburg, Ill.

According to the Muskegon Chronicle, letter carriers notify the Senior Services group when an elderly person's mail is not picked up. If local contact people are unavailable, a police officer investigates.

[From the Central Regional Bulletin, June 1, 1979]

MORE PO'S ON 'ALERT'

"Somehow the word didn't get out," says Arlington Heights, Ill. Postmaster Donald L. Swanson. His comment was prompted by the story, "Muskegon Carriers on Alert for Elderly," in May 18 Regional Bulletin. The story listed three other central region post offices—Ann Arbor, Mich., Chicago, Ill., and Galesburg, Ill.—as also having "alert" programs.

"Our program began February 1, and was announced in the papers. Both we and the community are delighted with it," he said.

Mr. Swanson wasn't alone. Also reporting on successful carrier alert programs after reading the article were Clair E. York, Muscatine, Iowa, postmaster, Louis J. Kerns, Mendota, Ill., postmaster and Richard Lux, Dupo, Ill. postmaster.

[From the Central Regional Bulletin, July 27, 1979]

MORE CARRIERS JOIN IN 'ALERT' PROGRAMS

Three more central region cities—including the largest and one of the smallest—have joined in community programs in which letter carriers keep a protective eye on senior citizens and handicapped persons on their routes.

If a carrier suspects trouble because mail hasn't been picked up, proper authorities are notified and a check is made to see whether a resident is ill or otherwise needs help.

The latest participants in the program are Chicago, which tested a pilot program more than 1 year ago and recently expanded it throughout the city; Des Moines, Iowa, and Cozad, Neb. (population about 4,600).

[From the Central Regional Bulletin, Sept. 28, 1979]

TWO MORE OFFICES JOIN IN 'ALERT' PROGRAMS

Two more central region cities have joined in community programs in which letter carriers form an "alert system" for senior citizens and handicapped persons on their route.

If mail hasn't been picked up, its a signal for the carrier to notify proper authorities to see if the resident is ill or needs help.

New participants are Skokie, Ill. and Westland, Mich.

[From the Central Regional Bulletin, Jan. 25, 1980]

FOUR DAYTON CARRIERS CITED FOR 'ALERT' AID

Four letter carriers were cited recently by the Dayton, Ohio post office for coming to the aid of residents on their routes.

Paul Nabor noted that a front door of a house was open. Checking, he found the occupant unconscious on the floor. The carrier called for medical help.

A similar incident faced Clarence Keefer, who became suspicious when a morning paper had not been taken in by afternoon. He, too, looked in, found the occupant semi-conscious, and called for an ambulance.

Carrier Charles Lindamood helped rescue a 10-year-old boy who had suffered minor injuries from a fall into a manhole.

Oscar Stueve, on his rounds, noted an individual slumped in a chair in a house on his route. Taking a closer look, the carrier realized the person had been shot. He notified police.

The Dayton post office has been participating in a postal alert program since last June.

[From the Central Regional Bulletin, Mar. 7, 1980]

ON THE 'ALERT'

When Louise Niemi was on her Benton, Ky. rural route recently, she saw a truck backed up to a house whose owner was in a rest home. Sensing something wrong, she arranged for the home's caretaker to be notified. He arrived to find several juveniles removing furniture, and ordered them to replace it. They later were charged with burglary. In a local newspaper interview, Postmaster J. R. Williams commended Mrs. Niemi, and said her actions demonstrated the post office's "Alert" program to make carriers aware of such occurrences, and help them to help others.

[From the Northeast Regional Bulletin, May 11, 1979]

CARRIER TO THE RESCUE!

Recently, while on his "appointed rounds," carrier Edward Hoey of the Great Neck, N.Y. post office noticed that one of his customers failed to pickup the previous day's mail or newspaper. He knew that the occupant was an 83-year-old gentleman so he rang the bell insistently and banged on the door. When he heard faint moans emanating from within, he rushed to a next door neightbor and called the police who found the man lying on the bathroom floor, injured and unable to move. There were contusions on his face and his back bore burns from the radiator against which he had fallen. From what later developed, he had been there for 2 days. Hospital personnel credited Mr. Hoey with saving the man's life.

For his performance, Great Neck's Postmaster Daniel McGrath presented carrier Hoey with a check and special achievement award.

[From the Northeast Regional Bulletin, Jan. 18, 1980]

ALERT CARRIER SAVES COUPLES

In line with the normal delivery of the mail, John E. Burke, a Jersey city letter carrier, noticed that a few days' accumulation had not been pickup up by one of his customers. Realizing this was a bit unusual, Mr. Burke saw a police car nearby and made known his concern to the officers. They went to the home; and, after some difficulty, got into the house and found the couple in a state of distress. As a result of this, contact was made with their parish priest; and, in short order, with the combined efforts of the police officers and others, the couples situation was taken care of. It was learned that for 2 days or more, they were unable to help themselves; and had it not been for the alertness of Mr. Burke, tragic consequences could have been the unhappy result.

Mr. Burke received a letter of commendation from his Postmaster Solomon McCants, Jr., for helping to prevent a serious tragedy.

Congrats, John; the NER is proud of you!

[From the Kettering Times, Dayton, Ohio, Nov. 21, 1979]

MAILMAN NABER'S CONCERN REWARDED

Paul Naber said it wasn't courage—just concern—that made him doublecheck his route one day in February 1978, when he discovered a 70-year-old women had suffered a stroke.

Mr. Naber, of 1435 Darst Ave., Dayton, has been a mail carrier on the route that includes parts of Kettering and Oakwood for more than 20 years. He was one of four letter carriers commended in a special program Thursday as part of the postal security alert program.

"I just happened to notice she didn't pickup her mail," he said. He saw her inner door open and thought she had guests. "But the more I thought about it, I thought I'd just stop by one more time to make sure she was all right."

After completing his route, Mr. Naber returned to 542 Acorn Dr. and discovered the occupant had been unconscious on the front hall floor after suffering a stroke nearly 6 hours earlier.

Mr. Naber notified the Oakwood police and rescue squads, which "really respond when you call them. They were there right away," he said.

The women died of the stroke she suffered only weeks after Mr. Naber first found her unconscious, he said.

The postal security alert program certificate and $250 award still was awarded to Mr. Naber for his outstanding performance on the job.

"They're trying to work out a program that we watch out for the elderly," Mr. Naber, 64, said, adding that letter carriers have an emergency number to call if they run into trouble on the route.

But Mr. Naber added that he doesn't expect to find much trouble on his 270-stop route, which takes him nearly 5 hours to complete. "They're really nice people—always thinking of you all the time."

Even after 31 years as a letter carrier, he has no plans to retire. "I think about it—but all the women on my route say I can't retire."

[From the Herald News, Joliet, Ill., Nov. 22, 1979]

MAIL CARRIERS INVOLVED IN NEW PROGRAM TO WATCH, HELP SENIORS

Senior citizens who live alone can be helped by a new program called carrier watch initiated recently by the Senior Services of Will County and the post office.

Local letter carriers will alert the center when mail is not picked up after 2 days by those registered for carrier watch.

The center will check on the senior and send aid if necessary.

Registrants can specify who to contact in case of an emergency and list any particular health problems. Decals placed inside registrant's mailboxes remind the carriers which homes need carrier watch.

Anyone over 60 in 11 communities may register for the program at the Senior Service Center, 310 N. Joliet St., 723-9713. Communities served are Bolingbrook, Channahun, Elwood, Frankfort, Joliet, Lockport, Manhattan, Mokena, New Lenox, Plainfield, Wilmington, and areas served by these post offices.

The program has been tried successfully in such areas as Chicago and Canton, Ohio. Nearly 100 seniors here have signed up in the first month, according to Dolores Larson, director of the Senior Services Center.

Ironically, "junk mail could be a life-saving thing," she said. And because "everyone gets mail," carrier watch is low cast and uniformly available.

Postmaster Charles L. Caton called carrier watch a "terrific program." He said that on their own, carriers for years have saved lives.

"They know the route, know the families, know the relatives. They really know what's going on in the neighborhoods. Without the carrier this program wouldn't be possible."

A different version is offered by crisis line. It is called telephone reassurance for the elderly at 722-3344.

Its operators make 75 to 80 calls a day each day, 365 days a year. They have on file the names of a neighbor, doctor, and relative in case no one answers at the arranged time.

"We chat for as long as they care to," said Sister Mary Frances Seeley, director of crisis line. Conversations range from gardens and needlework to grandchildren and recipes."

"We talk about whatever they want to talk about," she said. For some of the lonely old people, it is their only daily human contact. It's helpful "especially around the holidays," said Sister Mary Fran.

Crisis line also has a special teletype service for the hard of hearing. Daily teletype calls, as well as scheduling of various appointments for them, are conducted via machines at the Crisis Line Center and in the senior's home.

For snowbound seniors, crisis line can dispatch emergency food and medicine by snowmobile.

[From the News Press, St. Joseph, Mo., Aug. 15, 1979]

'POSTAL ALERT' AIDS SAFETY OF ELDERLY

The St. Joseph Post Office and Interfaith Community Services are forming a program to assure the safety and security of elderly persons in their homes.

The voluntary program, titled postal alert, is a new project for persons 55 or older. The main thrust of postal alert, officials said, is the cooperative effort between the post office and Inter/Serv.

"If we see mail in their box for a second day in a row, we'll alert Inter/Serv that there may be a problem," Vance Jezak, acting director of customer services, said.

"The most important thing about postal alert is if the post office and Inter/Serv can save one life, it'll all be worthwhile.

"Most mail carriers become personally identified with the people on their route. They often check with the people to make sure they're OK . . . so on a personal basis, the carriers have been doing this for some time."

Persons requesting the postal alert service are asked to provide information on who to call in case of an emergency. They are also asked to give permission for the police to enter the home if the situation warrants.

Jezak stressed that all information in the files of both the post office and Inter/Serv are confidential. Those wishing to become a part of postal alert should call Inter/Serv at 232-7779.

Postmaster L. G. Pinger, Jr. felt the program will give the post office a new avenue to help people.

"Right now, it gives us an agency to go to," he said. "If we find a proble, we can contact Inter/Serv and they have records on these people. It's a coordinating effort, and that's the beauty of the thing."

[From the Star, St. Louis, Mo., Jan. 23, 1980]

POSTMEN TO LOOK OUT FOR ELDERLY

An idea whose time came generations ago was formalized by local officials last Thursday. Officially called "carrier watch," the new United Way program is designed to meet the needs of the elderly and the isolated.

Unofficially, postal service officials say, it's been in effect since postmen first began delivering mail to private homes.

Patrons who request the free service will be watched over with extra care by their letter carriers. The program, which will begin as a pilot soon on the near North and South sides of the city and in both Wellston and Maplewood, provides, say the United Way, "for notification of emergency personnel in the event of apparent problems."

Those who want the service must first fill out a registration form that includes such information as persons—including physicians—who should be contacted in the event of an emergency, whether the resident lives alone, and any special health problems that may be relevent.

Persons are then sent a carrier watch sticker for the inside of their mail box, to insure, says the United Way, that only the registrants and their carriers know of participation.

The agency promises that the contents of the forms will be "held confidential and will be kept by the carrier watch program." And a postal service spokesman said the registration information will not end up in some Federal Government computer someplace because only private agency will handle the forms.

Program officials explained that the delivery personnel will know only because of the sticker, that certain patrons are enrolled. There will be no need for them to know why.

"Letter carriers have a personal relationship" with persons along their route, said Gus Frank, an official of Branch 343 of the National Association of Letter Carriers, AFL–CIO. "You almost know what their habits are."

Therefore, he explained, if those habits appear to have been broken or the mail starts piling up, carriers need only contact their supervisor—who will then get in touch with the proper social agency.

Except for the formal plan of action, said John Haake, president of the lcal letter carriers, "This is something carriers always did."

"They (the carriers) more or less have been doing this for years," said Joseph Mueckl of the Postal Service.

"Hopefully, this (organized program) will give people peace of mind, knowing that somebody is looking over them."

But, for the time being, only persons within four zip codes—63113, 63116, 63143, and 63133—will have that formal assurance.

"They wanted to get the bugs out first," explained Haake of the limited pilot program. "I was told that they tried this (ona large scale) in Chicago," he said, "and it fell flat."

"They're looking toward 6 months to 1 year (in this area)," he said. "It will take people that long to get the word out."

[From the Boston Seniority, May 1979]

Mail Carriers Provide 'Early Alert' When Trouble Arises

"Early alert," a security program for seniors utilizing mail carriers, is now available to seniors throughout the city.

Postmaster Phillip Sullivan, Police Commissioner Joseph Hordan, and Elderly Commissioner Elaine Guiney have found the program to be so successful in the pilot neighborhoods, West Robury and Roslindale, they are extending it to every neighborhood in the city.

"Early alert" is specifically designed to create an inconspicuous lifeline between social services and Older Bostonians, particularly those without regular outside contracts.

The first link in the early alert chain is the local mail carrier. Once he is notified that an elderly person on his route has joined the program, he uses a confidential method of identification to record their participation in such a way that any carrier servicing that route will be on the watch for any buildup of uncollected mail.

Should a carrier find a backlog of mail, even if it's only from the preceeding day, he immediately notifies the person at his post office designated to handle early alert reports, they in turn, notify the security office at the Elderly Commission.

James Daly, the Elderly Commission's security director, said, "If after receiving a report from the Postal Service, we are unsuccessful in making telephone contact with the subject, we then attempt to reach the close friend or relative designated on the registration card."

"Then," says Daly, "if all else fails, we ask the Police Department to check on the wellbeing of the elderly person. The police, if necessary, can enter the house or apartment to investigate."

"From all reports," says Commissioner Guiney, "the seniors who have taken part in the elergy alert program in Roslindale and West Roxbury, welcome the knowledge that someone cares enough to be looking out for their welfare."

Those interested in participating in the "early alert" program, may call the elderly hotline at 722–4646.

[From the Lima News, Lima, Ohio, May 30, 1979]

Mailman Honored for Effort to Save Life

Lima mail carrier John L. Williamson was awarded a letter of commendation Friday by Postmater Donald H. Carman for his efforts in vain to save the life of an elderly man on his mail route who had suffered an apparent heart attack last Wednesday.

Williamson, 48, said he had just finished his route and was about to deliver a parcel he had missed earlier in the day when "a lady came running out of the house, shouting "Help me, somebody help me," he said. It was about 3:10 p.m., he recalled.

He said he stopped his Jeep and ran into the Milton Avenue residence where he found the elderly man lying on the bathroom floor.

Williamson, who had been a medical technican with the U.S. Army during the Korean War, said he first dialed the police and told them to send the rescue squad.

"The man's wife was just too shook up to dial the phone," he said.

Next, he turned the man on his back in the narrow bathroom and administered artificial respiration, although he said it was apparent that "he was too far gone to help."

Nevertheless, Williamson continued his efforts to aid the victim until the city rescue squad arrived about 7 or 8 minutes later, he said.

The rescue squad gave the an oxygen and transported him to St. Rita's, where he was pronounced dead.

"I was just glad I was able to be there. I didn't know him personally, but I felt good that I was able to do something," Wiliamson said.

A 14-year veteran with the postal service, Williamson resides at 627 N. Charles St. He and his wife Lucille have four boys.

"We're very proud of him and pleased with his efforts," Postmaster Carman said. He added that letters of commendation are given "few and far between, so that they have some value to them."

Carman said the Postal Service's "operation alert" encourages carriers to be aware of elderly persons on their routes and their potential needs.

[From the Dayton Journal, Dayton, Ohio, June 18, 1979]

DELIVERING SECURITY—DAYTON PROGRAM WILL HAVE MAIL CARRIERS REPORT IF SOMETHING'S AMISS

"People are creatures of habit," said Oscar Stueve, Dayton letter carrier and local coordinator of operational postal security alert.

"Letter carriers are there almost everyday and know many of these habits. When someone breaks their habit, you notice."

Operational postal security alert is a type of neighborhood watch program in which the letter carriers are on the alert for suspicious activities or unusual occurrences on their route. The program particularly focuses on the elderly and the handicapped.

Soon in zip code zones 45406 and 45410, letter carriers will be delivering a combination registration form and letter of explanation to the senior citizens and handicapped persons on their routes.

"We are asking those interested in the program to fill out the card which will go into a confidential central file. It identifies them and lists people to call in an emergency," said Stueve. "The letter carriers get a special card with the alert number on it—225-2525. If they see something suspicious or unusual they call it. With the central file, there is one place to call that has all the correct information."

The program is a result of a pilot program started in the Bronx. It operated so well that it moved into the other major offices of the postal service. While sanctioned by the U.S. Postal Service, it receives no Federal funding and must be initiated by individual postmasters.

"Stueve and the letter carriers got it organized and we are giving it the backup," said Robert L. Harvey, director of Dayton Postal Customer Service. "We are furnishing the telephone number and the supervisors to respond to it. Then, drawing on the experiences from zone 06 and 10, we will extend it zone by zone until the Dayton delivery area is covered."

The United Way provided funds for the printing of the postal security alert registration forms and the letter carriers' cards.

"We wanted to help the program off the ground. We have set up crime alerts, block watches and have worked with the Council on Aging to better secure their houses. It is kind of an extension of this," said Bill Boos, AFL-CIO coordinator on staff for the United Way.

"The letter carriers know more about a neighborhood than any other group of people. If they see something that doesn't look right, they can call in on the phone that is in service all the time and get the authorities out there to investigate on the spot."

Many of the letter carriers already provide this service to a certain extent now. Stueve cited an instance last year where one of the senior citizens on his route didn't follow her usual habit of coming to the mailbox after his delivery. When he checked, he spotted her through a window lying on the floor. He called the police and emergency squad. The woman, who lived alone, had suffered a stroke.

"Our people are close to a lot of senior citizens. Sometimes we are their only outside contact." said Stueve. "I hope the people in Dayton will respond to thie program. It has a lot of potential."

Fairborn has had a similar program called the carrier watch program which has been in effect for about 1 year. "We worked through the local police and fire department, the city and with the local senior citizen groups to get it started," said Fairborn Postmaster Joe Zeller. "Luckily, we've only had a couple checkouts where people had been called away quickly and had not notified us."

Fairborn's registration includes information on the applicant's handicap or medical condition, allergy, doctor, and hospital preference. A copy of the registration is kept on file with the fire department and rescue squad. There is also a list in front of the route books so that in case a substitute would be on the route, he would be alert to a possible problem.

"One of the nice things about the program is that it is confidential. Some people don't like their neighbors to know if they have a problem, but it gives us an edge," said Zeller. "If there is a history of maybe heart trouble, the fellows can be partially prepared before they even get these so they can act that much quicker to save someone's life."

[From the Chicago Tribune, Chicago, Ill., June 7, 1979]

MAILMEN 'ON ALERT' TO AID AGED, HANDICAPPED

Alone vulnerble, and sometimes friendless, the aged and handicapped live with a constant fear that a household accident or illness will leave them helpless in their homes with nowhere to turn.

To allay that fear, the post office and the Mayor's office for Senior Citizens and Handicapped (MOSC/H) are initiating a citywide program called "carrier watch" to alert mailmen to possible trouble in the homes of the aged and infirmed.

"The mailman puts a red decal inside the mailbox to alert him should he see an accumulation of mail for several days. If he notices this backlog, he notifies our office and we contact the home," said George Ducas, director of community education for MOSC/H.

A pilot program begun about 15 months ago in scattered areas of the city was so successful that it has been expanded to encompass the entire city, Ducas said.

"It's particularly appealing to the elderly because it's discreet. It does not advertise that here is an elderly person who is vulnerable. Only the postman knows," Ducas said.

Once an accumulation of mail is noticed and the mailman contacts MOSC/H, a volunteer phones the person to see if everything is all right.

"In some cases, the person may be out of town or on vacation. But in another case, we might find a person lying helpless on their kitchen floor with a broken hip. If we can't make contact, we may come to the point where we contact the polce to enter the home to investigate," Ducas said.

If a person does not have a phone, a MOSC/H field worker will go to the house to investigate.

"In some cases, perhaps in a neighborhod of single family dwellings, the mailman will know the person and investigate himself. But in the majority of cases, the followup is done by us," Ducas said.

The program was originated in New York State, but like other senior citizen programs, has spread to other parts of the country, Ducas said. He said carrier watch is just one of several "assurance" programs, such as the "I'm OK" signs, and friendly visitor.

The only drawback to the program is that homes with mail slots cannot participate because it is impossible for the mailman to see the mail accumulation.

For those interested in registering for Carrier Watch, phone MOSC/H at 744-4016 or write MOSC/H, Carrier Watch, 180 N. La Salle St., Chicago 60601.

[From the Muncie Star, Muncie, Ind., June 3, 1979]

SIDE REMARKS

A little-used but fairly innovative service offered by the U.S. Postal Service from Muncie to and from a number of cities is known as express mail.

It's expensive and difficult to obtain (you have to go to the main post office on Memorial Drive, and a piece weighing less than a pound destined for a Texas city costs $7.65), but before noon delivery the next day is guaranteed in many cases, and second-day delivery by noon in many others.

Even after you get to the main post office it takes some doing to use express mail.

First you stand in a regular line and eventually reach a window clerk.

Then you are handed an express mail tag, which you then take back to a table (losing your place in line) and fill out.

Then you wait a second time to be served by a clerk, who must check out whether first or second day service is guaratneed.

Despite the consumption of time and money, the idea appears to be a good one. And if the postal people don't make good on their promied delivery, you get your money back.

[From the Missourian, Washington, Mo., Dec. 19, 1979]

HEART ATTACK VICTIM SAVED BY POSTAL WORKERS

An elderly Washington woman's life was saved because someone nearby knew CPR (cardio-pulmonary resuscitation) techniques when she collapsed in the Washington post office Monday morning.

Postal workers Dave Holdmeyer and Ed Searcy immediately began resuscitation techniques to revive Tina Hornbuckle, who suffered a cardiac arrest in the lobby about 10 a.m., Monday. Their efforts definitely played a big part in saving the woman's life, Terry Budemeyer, ambulance coordinator, said.

Other factors also were in Mrs. Hornbuckle's favor, such as the fact that the daytime ambulance crew was at city hall when the emergency call came in and were on the scene in less than 2 minutes, but the immediate efforts by Searcy and Boldmeyer sustained the woman and made the ambulance crew's work more effective, Buddemeyer said.

Mrs. Hornbuckle, 83, has been listed in critical condition in the intensive care unit at St. Francis Mercy Hospital since she was admitted Monday morning. Her condition was unchanged Wednesday.

Witnesses at the post office said Mrs. Hornbuckle collapsed after purchasing stamps at a window. The woman had stopped breathing and was turning blue, according to one person at the scene, when Holdmeyer began a chest massage and Searcy mouth-to-mouth resuscitation on the heart victim.

Holdmeyer continued to administer the massage when Budemeyer and Donna Micka, assistant daytime coordinator, arrived and began giving the victim oxygen. Mrs. Hornbuckle began breathing on her own after electro-shock was administered, Buddemeyer said.

Holdmeyer, captain of section one and an advanced first aid and emergency care instuctor with the fire department, then went along to the hospital in the ambulance to answer any questions by doctors in the emergency room. Searcy is a retired fireman and a former rescue squad captain.

Buddemeyer said it was fortunate that Holdmeyer was at the post office, since he usually is out on a route at that hour of the morning.

The ambulance coordinator applauded the two men for their quick action. "It was great that they were there. This shows how important CPR is," Buddemeyer remarked.

Much emphasis and attention has been given in the last few years to CPR techniques and need for training in the resuscitation procedures. Courses in CPR are offered on a regular basis to the public.

"The key is that someone was there to maintain oxygen and circulation of the victim through CPR," Buddemeyer said. Two minutes can make a big difference," he said, explaining that permanent brain damage results if oxygen is cut off for 4 minutes.

Bill Halmich, assistant fire chief, said because of his action in the emergency, Holdmeyer will be nominated for the life saving aware of the Fire Fighters Association of Missouria next April. The group gives one such award each year at its convention, based on a review of nominations from member organizations. The next convention is scheduled to be held in St. Louis county.

[From Oshkosh Northwestern, Oshkosh, Wis., December 21, 1979]

MAIL CARRIER HONORED FOR SAVING LIFE

Oshkosh mail carrier Everett Zellmer, 307 W. Lincoln Ave., holds a certificate of commendation he received from Mayor Kenneth Schiefelbein at Thursday night's Common Council meeting for saving the life of Lester Pomering, 88, of 626 W. 17th Ave., on Dec. 11. Zellmer was delivering mail when he heard a muffled car engine running. He found Pomering unconscious on the front seat of the car in his closed garage, with the motor running. Zellmer pulled Pomering out of the garage, gave mouth-to-mouth resuscitation, and had a neighbor call an ambulance. Pomering had passed out in the car after a heart attack.

[From the Northern Virginia Sun, Arlington, Va., February 8, 1980]

POSTMAN HELPS WOMAN FLEE FIRE

Arlington.—A postal deliveryman for 32 years, John H. White Thursday pulled a young epileptic from a burning house in the 600 block of North Oakland Street.

The woman, Venessa Fisher, 26, was resting comfortably in Arlington Hospital a few hours after the fire at 11:26 a.m.

John Smith, a deputy fire marshall, said damage to the home was estimated at $12,000, with $3,000 damage to contents. The blaze started in the bedroom, Smith indicated.

Fisher is a foster sister of Veronica Thompson, who lives in the home, Smith said. Thompson was at work when the fire occurred, Smith added.

The woman was in a siezure when White went through the unlocked front door to determine if anyone was inside, he said. White explained he was alerted to the fire by James Hilleary, a neighbor who lives in the 3700 block of North 6th Road.

Hilleary said he was on his way to noon church services when he saw the smoke coming from bedroom windows at the rear of the burning building. He then reported the fire and went to help White at the scene.

A postman on this route for the last four years, White said he gave Hilleary the address of the building before he found Fisher coughing as she fell down the steps inside the home.

She was having "seizure of some sort," White said, and he helped her through the door to the outside.

[From The Press, Atlantic City, N.J., August 3, 1979]

WOMAN RESCUED BY MAIL

Norma.—Reba Krassenstein isn't dead today, thanks to the local postmistress.

Mr. Krassenstein, 76, was suffering from dehydration Thursday when she was taken from her home on Almond Road here by state police and by the Norma Alliance Volunteer Fire Company's rescue squad.

The postal official, Virginia Hurst, called the police after noticing Mrs. Krassenstein hadn't picked up her mail in several days.

When rescuers broke into her home, they found Mrs. Krassenstein lying in bed, "talking incoherently."

Rescuers said there was no food in the house and nothing to drink except tap water—which she apparently didn't drink.

Mrs. Krassenstein was reported in satisfactory condition in Newcomb Hospital late Thursday afternoon.

Salem County health officials are trying to find out just how and why the woman came to be in her condition. She may have been a victim of the prolonged, intense heat that lies folded over this rural community like a stifling blanket, or there may have been a medical problem.

Her rescuers believe she was without food and drink for three to five days and she probably would have died if she had gone unnoticed much longer.

Ms. Hurst said she first called Mrs. Krassenstein's next door neighbors who went to the door and found two or three days worth of newspapers outside.

"And they said she hadn't done her Sunday wash," Ms. Hurst said.

The neighbors told her they had seen the elderly woman, who lived alone, walking around a couple of days ago.

But that didn't satisfy the postmistress.

"I figured I'd better call the state police," she said. "They took it from there."

"I did what anybody would have done, Ms. Hurst said.

After breaking into the home, police barricaded the building to deter vandals, and the elderly woman's neighbors got together some of her belongings and took them to the hospital.

Some of Mrs. Krassenstein's relatives—who don't live here—are also helping.

[From the Spartanburg Herald, Spartanburg, S.C., August 23, 1979]

THE DOCTOR TURNED OUT TO BE THE MAILMAN

Inman.—"Are you a doctor?" asked the patient, upon regaining consciousness. "No, I'm just the mailman," came the reply.

The incongruous conversation took place in Inman in late June between R. L. Freeman and Wayne McAbee. Recently McAbee, an Inman postal employee for 17 years, and Tim McDowell, a part-time employee of the Inman Post Office, received special achievement awards from the U.S. Postal Service for the part they played in possibly saving Freeman's life.

The day began like any other. McAbee began the first part of his daily 14-mile walking route. He was accompanied by Poochie, which has accompanied him on his rounds for three years, and Blackie, which showed up for work with Poochie one morning about eight months ago. Nobody knows who owns the dogs or where they live. But they make the rounds with McAbee every day.

About 11 a.m., the postman started up the steps at the Freeman home on E Street to make a delivery. He was startled when Mrs. Freeman appeared and exclaimed, "Wayne, do something! My husband's dying!"

He ran into the house and found Freeman on the couch, apparently unconscious. "I checked his heart, but I couldn't find a heartbeat or a pulse. I knew if his heart wasn't beating, he couldn't survive."

McAbee says he figured that whatever he might do couldn't hurt, and could help. He told Mrs. Freeman, who had already called the Rescue Squad, to get a cold towel to wipe her husband's face. Although McAbee had never had any training in lifesaving techniques, he began a rhythmic heart massage.

Soon, Freeman gasped and began a labored breathing. He was conscious when Rescue 10 arrived.

"When we pulled up and I saw the dogs," recalled McDowell, "I said, 'Wayne's here'." McDowell is a volunteer Emergency Medical technician for Rescue 10. He was off duty at the post office and was available to answer the rescue call with a partner. (McDowell is also captain of the Inman Fire Department.)

"We checked the vitals. Blood pressure was low. Pulse and respiration were fair. He said something about popping some plastic tubing in his leg. He had internal bleeding that I couldn't do anything about. I kept a monitor on his vitals and we moved him to General Hospital. They were ready for him and did emergency surgery as soon as we arrived."

McAbee resumed his mail route but said it took him another half hour to complete deliveries on two more streets. "Everybody wanted to know what had happened."

During surgery, doctors discovered that Freeman's suspicions were wrong. Plasting tubing from Freeman's heart into his leg, which had been placed in November of 1978 during extensive bypass surgery, was not faulty. He had suffered a ruptured aneurysm in the chest area.

Freeman, a supervisor with Burdette Manufacturing Co. in Roebuck, is back on a full schedule at work. "Our plant operates on a four 10-hour day basis. Actually, my day runs more like 11 hours now." He is quick to credit McAbee with saving his life.

But McAbee counters, "I always try to help somebody each day. I guess he (Freeman) was just the one I helped that day."

POSTAL SUBSIDIES FOR POLITICAL MAILINGS

Question: The Congress provided the Postal Service with approximately $4 million in 1980 for subsidies for political mailings. It is the Committee's view that once this level is reached the Postal Service should consider there to be a failure of appropriations and adjust the rates accordingly. How much has the Postal Service expended this year to date for subsidies for political mailings? What is the projection for the rest of the year?

Answer: It is quite difficult to project through for the balance of the year. We note that authorized political mailings are beginning to build up and would expect a considerable increase in activity for the balance of the year. I doubt that anyone can predict the political mailing activity around the country for the balance of the year with any greater certainty than they can predict the outcome of the myriad elections that will take place. However, the following table provides the mail volumes and revenue forgone through March 21, 1980, which is the end of Accounting Period 6 (A/P6), Fiscal Year 1980.

QUALIFIED POLITICAL MAILINGS
SUMMARY

GOVERNMENT FISCAL YEAR 1980
(10-01-79 to 09-30-80)

PERIOD	PIECES	REVENUE FORGONE	
		This Period	Yr-to-Date
10-01-79 to 10-05-79 (Period Between Federal & USPS Fiscal Year)			
Major/Minor	1,078,117	$57,127.32	$57,127.32
Other	3,233	100.23	100.23
Total	1,081,350	57,227.55	57,227.55
A/P 1			
Major/Minor	3,351,440	178,222.01	235,349.33
Other	27,077	839.39	939.62
Total	3,378,517	179,061.40	236,288.95
A/P 2			
Major/Minor	1,083,009	58,075.95	293,425.28
Other	29,244	906.57	1,846.19
Total	1,112,253	58,982.52	295,271.47
A/P 3			
Major/Minor	1,975,079	104,682.54	398,107.82
Other	2,547	78.96	1,925.15
Total	1,977,626	104,761.50	400,032.97
A/P 4			
Major/Minor	3,193,903	169,276.91	567,384.73
Other	-0-	-0-	1,925.15
Total	3,193,903	169,276.91	569,309.88

A/P 5			
Major/Minor	3,590,428	190,292.68	757,677.41
Other	-0-	-0-	1,925.15
Total	3,590,428	190,292.68	759,602.56
A/P 6			
Major/Minor	5,203,443	$275,782.48	$1,033,459.89
Other	-0-	-0-	1,925.15
Total	5,203,443	275,782.48	1,035.385.04

NEW PAYROLL SYSTEM - COMMITTEE MISLED BY POSTMASTER GENERAL?

Question: Last year we discussed the large number of complaints that I and other Members had received about the problems that were caused by the new payroll system implemented in 1978 to bring the Postal Service into compliance with the Fair Labor Standards Act Amendments of 1974. When we asked the Postal Service about this last year the Postmaster General told us "...we felt confident that we could get the system in without major problems, and we were wrong". (P. 584, Senate Hearing Record)

The Committee has been informed by several individuals that the Postal Service knew full well that the system could not be implemented by May 22, 1978, and so testified before Judge Green and Judge Tyler but proceeded with the premature implementation to avoid a $3 million court fine for failure to implement. Isn't that essentially correct?

Answer: The issue of whether the Postal Service prematurely implemented its redesigned payroll system on May 22, 1978, to avoid the consequences of non-implementation, i.e., sustaining an additional sum in damages of $3 million, was recently fully litigated in arbitration before retired Federal District Court Judge Harold R. Tyler, Jr. Judge Tyler's decision and order, which are attached and incorporated herein by reference, held that the Postal Service's redesigned revised payroll system was properly implemented and that the plaintiffs in the arbitration failed to prove that the system was not timely and successfully implemented. I might add that Judge Tyler relied upon much testimonial evidence and voluminous documentary evidence, including all of the statements the Committee has referenced, in reaching his conclusion.

(A copy of the arbitration decision follows.)

AMERICAN ARBITRATION ASSOCIATION
COMMERCIAL ARBITTATION TRIBUNAL

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In the Matter of : CASE NUMBER

U.S. POSTAL SERVICE PAYROLL : 16 10 0049 79
REDESIGN ARBITRATION
(Kaplan - Smith, et al.) :

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Award of Arbitrator

I, the undersigned arbitrator, having been designated in accordance with the Arbitration Agreement entered into by the above named parties and dated March 15, 1979 and having been duly sworn and having duly heard the proofs and allegations of the parties and their counsel, recite that:

The above-captioned arbitration was heard orally on April 17th and June 13th and 14th, 1979. Thereafter, either by agreement of counsel or by direction of the arbitrator, additional written submissions and documents were received by the arbitrator, the last submission occurring on February 15, 1980. Based upon the testimony adduced at the hearings and all the submissions of the parties and their attorneys, the arbitrator awards as follows:

The award is in favor of the United States Postal Service (USPS); thus, petitioners are not entitled to recover the additional sum of $3,000,000 in damages and claimed additional attorneys fees in any amount.

Findings of fact and conclusions of law will be filed with the American Arbitration Association, Washington office, within 15 days from the date hereof.

The administrative fees and expenses of the American Arbitration Association shall be borne by the parties equally. Said fees and expenses shall be paid as directed by the American Arbitration Association. The fees and expenses of the arbitrator shall be borne by the parties equally and shall be paid as directed by the American Arbitration Association.

This award is in full settlement of all claims submitted to this Arbitration.

Dated: New York, New York
February 21, 1980

Harold R. Tyler, Jr.

AMERICAN ARBITRATION ASSOCIATION

- x

In the Matter of : CASE NUMBER

POSTAL SERVICE PAYROLL REDESIGN : 16 10 0049 79

ARBITRATION (KAPLAN/SMITH, et al.) :

- x

The above-captioned arbitration was heard on April 17, 1979, and June 13-14, 1979. Post-hearing briefs were submitted to the arbitrator on January 17, 1980. Thereafter, either by agreement of counsel or by direction of the arbitrator, additional written submissions and documents were received by the arbitrator, the last submission occurring on February 15, 1980. Based upon the testimony adduced at the hearing, and all the submissions of the parties, the arbitrator makes the following Findings of Fact and Conclusions of Fact and Law.

I. INTRODUCTION

1. Petitioners Mozart G. Ratner, Gerald M. Feder and Jules Bernstein are signatories to a settlement agreement, referred to by the parties as the Kaplan/Smith Settlement Agreement (the "Settlement Agreement"), entered into with the United States Postal Service ("USPS"). The Settlement Agreement arose out of, and served to terminate, certain lawsuits brought by petitioners on behalf of 90,770 employees of USPS in the United States District Court for the District

of Columbia (the "Kaplan/Smith cases") alleging violations of the Fair Labor Standards Act of 1938, as amended, 29 U.S.C. §201 et seq. (the "FLSA"). In this arbitration, petitioners seek to enforce certain provisions of the Settlement Agreement in their representative capacities as counsel to the plaintiffs in the District Court procceedings and, in addition, claim to represent the interests of all FLSA-covered employees of USPS who were not plaintiffs in the District Court proceedings, but who allegedly are third party beneficiaries of the Settlement Agreement.

2. Respondent USPS is "an independent establishment of the executive branch of the Government of the United States". 39 U.S.C. §201. USPS is an employer within the meaning of Section 3(d) and (x) of the FLSA, 29 U.S.C. §203 (d) and (x), and an enterprise engaged in commerce or in the production of goods for commerce within the meaning of Section 3(s) of the FLSA, 29 U.S.C. §203(s). USPS is a party to the Settlement Agreement in its capacity as an FLSA-covered employer.

3. The Settlement Agreement provides in pertinent part:

> I C. USPS is in the process of implementing a new payroll system designed to comply with the FLSA. The parties, therefore, desire that (1) the redesigned payroll system comply in all respects with the FLSA, that (2) henceforth, all plaintiffs be compensated properly, and that (3) all plaintiffs be compensated for violations which have occurred since May 1, 1974.

* * *

> IIIB. To compensate plaintiffs in Kaplan, Smith Malinski, Morrell, Mares, Trammell, Becerra, Barton and Avery for uncompensated suffer or permit time, USPS agrees to pay each plain-

> tiff a proportionate share of an amount equal to $53 million dollars, unless the USPS fails to implement its new payroll redesign program by May 22, 1978, in which case such amount shall be $56 million dollars. The amounts of such payments to plaintiffs shall be determined in accordance with a procedure to be agreed upon by plaintiffs' counsel.
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> * * *
>
> IV. Counsel for the plaintiffs in *Kaplan*, *Smith*, *Malinski*, *Morrell*, *Mares*, *Trammell*, *Becerra*, *Avery*, and *Barton* will be paid counsel fees by USPS in an amount equal to: * * *; (2) 5% of the $53 million, if USPS's new payroll redesign program is in nationwide operation on or before May 22, 1978, or 5% of $56 million if it is not.

4. On or about June 20, 1978, USPS notified petitioners that its payroll redesign system was implemented as of May 20, 1978, and that pursuant to the terms of the Settlement Agreement its suffer or back pay obligation was established at $53 million.

5. On or about October 13, 1978, following various correspondence between the parties, Ratner, on behalf of petitioners, declared that a dispute had arisen under the Settlement Agreement and demanded arbitration pursuant to Article VI.* Ratner contended that USPS

> "wrongfully put the new program into operation prematurely, to avoid the contractual consequences of non-implementation by May 22, 1978, despite the foreseen and foresee-

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* Article VI provides: "It is agreed by the parties that any disputes regarding the meaning or application of any provision of this agreement shall be subject to final and binding arbitration."

> able adverse consequences to plaintiffs and other Postal Service employees of non-payment, delayed payment, reduced payment and inadequate payment of wages when due."

6. Petitioners elaborated on their claims in a letter to USPS dated November 8, 1978, claiming that USPS attempted to implement the payroll redesign system "without completing the contemplated training observation, operational testing and step by step installation program" which had been contemplated by the parties when they entered into the Settlement Agreement. As a consequence, petitioners concluded, and argue in this arbitration, that USPS prematurely implemented the payroll redesign system and that this constituted a tortious breach of the Settlement Agreement. Further, petitioners contended, and continue to urge, that this alleged tortious breach of the Settlement Agreement rendered USPS liable, not only for the additional sum of $3 million plus attorneys' fees as provided for in Articles IIIB and IV of the Settlement Agreement, but also for "consequent damage to all Postal employees who sustained injury therefrom, not merely plaintiffs, and for attorneys' fees independent of those provided for in the Agreement . . . ."

7. It is the contention of USPS that petitioners may not represent any USPS employees other than those who were plaintiffs in the Kaplan/Smith cases.

II. ISSUES PRESENTED

8. Whether USPS's payroll redesign system was implemented by May 22, 1978 within the meaning of the Settlement Agreement.

9. Whether USPS installed the new system prematurely and in bad faith in order to avoid the consequences of non-implementation by May 22, 1978, i.e., an additional sum in damages of $3 million plus attorneys' fees.

10. Whether petitioners represent in this proceeding

all FLSA-covered employees of USPS who were not plaintiffs in the Kaplan/Smith cases, as well as those employees who were plaintiffs in those related litigations.

III. FINDINGS OF FACT

11. Effective May 1, 1974, the FLSA became applicable to USPS.

12. Beginning in September 1975, various lawsuits were filed on behalf of various categories of postal employees against USPS to recover damages for alleged regular rate of pay and suffer and permit time violations of the FLSA. On February 25, 1976, those related cases were consolidated by the United States District Court for the District of Columbia. Those cases have been referred to herein as the Kaplan/Smith cases.

13. In November 1975, USPS requested its independent auditors, Ernst & Ernst, to perform an analysis of the impact of the FLSA on its then existing payroll system. On February 13, 1976, Ernst & Ernst recommended a substantial redesign of the USPS payroll system to ensure compliance with FLSA requirements.

14. In March 1976, USPS distributed bidding packages for its payroll redesign system to the "Big Eight" accounting firms. The planned project was substantial, if not formidable, because USPS has a payroll of between 650,000 and 700,000 employees, complex pay rules, and approximately 30,000 different points of data entry and data creation. Furthermore, its annual payroll is approximately $13 billion.

15. Late in March 1976, Price Waterhouse & Co. ("PW") was awarded the contract to develop and implement a redesigned payroll system that would comply with the FLSA. Lawrence W. Schmitz, a senior manager for PW, was appointed Project Manager for the redesign effort and Benton B. Warder was designated as the PW partner in charge of the project.

Both men from PW had extensive experience designing large payroll systems in both the public and private sectors.

16. Thereafter, employees of USPS and PW worked on the payroll redesign project. A payroll coordinating committee was established to supervise the efforts of the redesign team and to consult from time to time with other government agencies and with the various unions and management associations representing various USPS employees.

17. Initially, the new payroll system was scheduled for implementation in the latter part of January 1978. Not surprisingly, however, given the magnitude of the project, problems were encountered which delayed the implementation date.

18. Some delay was occasioned by events which occurred in the Kaplan/Smith cases. On July 20, 1976, District Court Judge June L. Green granted partial summary judgment for the plaintiffs in those lawsuits, finding that USPS had violated certain provisions of the FLSA since May 1, 1974. On October 4, 1977, Judge Green issued a memorandum opinion and order wherein she made detailed findings of the way in which USPS's timekeeping practices violated the FLSA. The Court's ruling required USPS to make significant changes in the manner in which it identified and retrieved time and attendance data.

19. On January 13, 1978, Judge Green, in another memorandum opinion, expressed her understanding that USPS's new payroll system would be operational later that month and would remedy the various identified FLSA violations. However, on January 20, 1978, USPS moved for an order modifying the Court's January 13 order to conform to the then projected date of final implementation of the new payroll system. The motion was based on the affidavit of Senior Assistant Postmaster General Francis X. Biglin, dated January 17, 1978. Mr. Biglin estimated that the new system could not be imple-

mented earlier than the latter part of May 1978 in order "to minimize the risk of payroll errors." Judge Green entered an order on February 7, 1978, directing USPS to have the new payroll system operating nationwide by March 31, 1978 or face additional damages.*

20. On March 31, 1978, USPS moved the District Court to reconsider its order of February 7 establishing a March 31 implementation deadline. The memorandum of law and affidavit of Mr. Biglin submitted in support of the motion stated that the new system still was not functioning properly because of a combination of programming and testing delays and timekeeper errors. USPS claimed that a payroll system breakdown could be avoided only if the Court extended the deadline for nationwide implementation of the new payroll system. Mr. Biglin believed that implementation in the Western Region could be accomplished by May 20, 1978, and that nationwide implementation could occur by September 9, 1978.

21. On April 1, 1978, petitioners and USPS entered into the Settlement Agreement which served to dispose of the Kaplan/Smith cases and related litigation then pending in the United States District Court for the Western District of Tennessee. In this agreement, USPS (a) acknowledged violating the FLSA in some respects; (b) agreed to make certain back wage and liquidated damage payments to the plaintiffs pursuant to a certain formula; (c) agreed to pay attorneys' fees to plaintiffs' counsel based upon a certain formula; and (d) agreed to pay additional damages and attorneys' fees if the new payroll system designed to comply with the FLSA in all respects was not implemented by May 22, 1978.

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* Judge Green already had assessed, in her order of January 13, liquidated damages "in the amount of 80% of any compensatory damages for which USPS is ultimately found to be liable" for violations of the FLSA. See 29 U.S.C. §216 (b).

22. Thereafter, USPS and PW adopted a plan which called for nationwide implementation by May 20, 1978. Under that plan, certain phases of the new payroll system were to be implemented in the Western Region on March 25, 1978. The so-called "Remainder of System" then was to be implemented at the San Bruno Postal Data Center on April 22, 1978, and at the Minneapolis and New York Postal Data Centers on May 20, 1978.

23. While the "Remainder of System" was not implemented at the San Bruno Postal Data Center until May 6, 1978, the balance of the phased implementation plan was adhered to and the new payroll redesign system was operational nationwide on May 20, 1978.

24. Prior to the implementation, 50,000 USPS employees were given extensive training on how to complete timecard data for input to the new system.

25. Prior to the implementation, PW had primary responsibility for testing the new system. The testing consisted of "unit", "string", and "system" test configurations. "Volume" testing also was done to simulate a full load operational environment. All such tests were completed with substantial success prior to May 20, 1978.

26. The payroll redesign system implemented on May 20, 1978 complied with the FLSA. The procedures for gathering the necessary data met FLSA requirements, the time and attendance data were correctly gathered for input into the new payroll system, and the data was successfully run through the FLSA pay calculation routines of the system.

27. The operational performance of the new payroll system as it related to the plaintiffs covered by the Settlement Agreement was reasonably satisfactory. While it is true that after the new system was implemented, approximately 3% of the plaintiffs experienced adjustments to their pay data, the adjustments were the result of human error; they

did not occur because of system design or operation. Given the magnitude and complexity of the payroll system, this was, and is, an acceptable error rate. Indeed, it probably cannot be reduced.

28. Start-up problems also affected some USPS employees who were not plaintiffs in the Kaplan/Smith cases. These problems were relatively minor and affected a small number of USPS employees. For example, the most serious payroll problem after implementation was that some employees did not receive paychecks and had to be provided cash advances. However, those employees not receiving paychecks amounted to no more than 0.75% of the USPS bi-weekly payroll. The existence of such relatively minor problems fails to establish that the implementation of the new payroll system was a failure.

29. Therefore, despite the fact that there were start-up problems with the new payroll system, overall the implementation was timely and successful.

IV. CONCLUSIONS OF FACT AND LAW

30. Petitioners have failed to prove by a preponderance of the evidence that the redesigned payroll system, as implemented on or about May 20, 1978, did not comport in significant respects with the FLSA. Specifically, contrary to petitioners' claims:

a. the two computer programs, Pay Adjustment Edit and Pay Calc with Adjustments, had nothing to do with the initial calculation of pay for hours worked under the statute; and

b. revised instructions and procedures governing timekeeping and payroll practices of the system were not ultimately found by the Department of Labor to be inconsistent with or out of compliance with the statute; and

c. petitioners' evidence* consisting of 19 affidavits from timekeepers located at one of six field locations establish that some employees may not have followed the new operative procedures -- which, if true, does not prove that the system was improperly designed or failed to comply with the statute.

31. Petitioners' submission to the arbitrator, dated December 31, 1979, fails to support the conclusions which they attempt to draw therefrom. By way of illustration, the relevant GAO letter report attached to the December 31st submission addressed cash advances to certain USPS employees. There is no particular evidence that these cash advances were of significance in relation to the petitioners' class. Moreover, errors in the cash advances were of minimal significance when viewed against the entire payroll of USPS during any pay period of 1978.

32. Petitioners' references to the testimony of Postmaster General Bolger before the Senate Subcommittee on Appropriations in May, 1979, are not persuasive evidence, if indeed competent evidence, to support petitioners' contention that the payroll redesign system did not function effectively. Indeed, when one looks at the Postmaster General's testimony as a whole, it would appear that he was merely indicating that there were expectable "bugs" in the new system and that they were being worked out satisfactorily.**

33. Contrary to the assertions of petitioners, the new payroll system functioned at a tolerable, if not

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* As counsel for USPS has urged, this may be evidence of dubious competence.

** Similarly, the exchange of correspondence between Mr. Bolger (his of January 16, 1980) and Congresswoman Gladys N. Spellman (hers of January 2, 1980), of which the arbitrator takes notice took place in fact, fails to establish that the payroll redesign system was not timely and successfully implemented.

minimal, error rate of approximately 3% in respect to the approximately 90,000 plaintiffs covered by the Settlement Agreement. Furthermore, payroll errors were also kept to a tolerable level in respect to FLSA-covered employees of USPS who were not plaintiffs in the Kaplan/Smith cases.

34. Petitioners have failed to establish that USPS did not implement its redesigned payroll system by May 22, 1978 within the meaning of the Settlement Agreement. *A fortiori*, petitioners have fallen short of the mark of proving facts sufficient to support their theory of recovery based upon what they call "a tortious breach of the settlement agreement". As they have recognized, in order to prevail on this theory, petitioners must prove a breach by the USPS so far reaching and wilfull as to constitute a purposeful installation of a patently defective payroll redesign. *Cf.* *Brown v. Coates*, 253 F.2d 36, 39 (D.C. Cir. 1958); *Walter v. Sheldon*, 10 N.Y.2d 401, 223 N.Y.S.2d 488, 1[illegible] N.E.2d. 497 (1968). Unless the undersigned were to totally disregard all of the testimony in this case of USPS and PW officials as being untruthful or in complete error, it is impossible to find any evidence to this effect whatsoever.

35. Petitioners have been unable to prove that the Settlement Agreement was not performed by USPS adequately and in good faith.

Accordingly, because the undersigned finds that petitioners have failed to meet their burden of proving that USPS breached the Settlement Agreement, the petitioners are not entitled to recover an additional sum of $3 million on behalf of the plaintiffs in the Kaplan/Smith lawsuits or counsel fees of an additional $150,000, nor are they entitled to recover damages on behalf of USPS employees who were not plaintiffs in Kaplan/Smith. Let the award, therefore, be in favor of USPS.

Dated: New York, New York
February 27, 1980

Harold R Tyler Jr.

Harold R. Tyler, Jr.
Arbitrator

Question: Was the Committee misled last year when it was told that "We felt confident that we could get the system in without major problems"?

Answer: The Subcommittee was not misled by the Postal Service's testimony.

Question: What is the status of the continuing court cases whereby postal employees have sued for back pay due them under the Fair Labor Standards Act Amendments of 1974?

Answer:

A. "Elia Settlement Agreement"

Approximately 60,000 employees are covered by this litigation. Numerous issues relating to study, travel and training have been raised. Two decisions on the issues of voluntary bid and reasonable time for scheme and MPLSM study have been issued by the Assistant Secretary of Labor. Those decisions are being reviewed by our attorneys to determine their impact on the Postal Service.

B. Marshall v. United States Postal Service, C.A. No. 78-602 (D. D.C.)

This suit has been brought on behalf of all of the nonexempt employees who have been employed by the Postal Service any time after May 1, 1974. The issues cover almost the entire range of issues relating to study, travel, and training which were raised in the above-referenced Elia matter. No decisions have been issued.

C. Evans v. United States Postal Service, C.A.No. 78-2415 (D. D.C.)

This suit has been brought on behalf of approximately 210,000 named plaintiffs, although it also raises a class action allegation on behalf of all non-exempt employees in the Postal Service who were not covered by the above-referenced Elia Settlement Agreement and the companion settlement in Smith/Kaplan. This suit alleges numerous FLSA violations involving the Postal Service's study, travel, and training policies and is strikingly similar to the above-referenced Marshall suit. No decisions have been issued.

D. Atwood v. United States Postal Service, C.A. No. 79-1808 (D. D.C.)

This suit basically maintains that when the Postal Service settled the Smith/Kaplan matter it agreed orally to compensate all other non-exempt employees in the Postal Service in the same manner that it compensated the Smith/Kaplan plaintiffs (*i.e.*, a non-plaintiff agreement). No decisions have been issued.

E. Brice v. United States Postal Service, C.A. No. 79-691 (D. D.C.)

This suit is a class action brought on behalf of all Postal Service non-exempt employees who will receive from FLSA backpay payments; it basically claims that such employees are entitled additional annual and sick leave benefits as well as retirement, military and holiday leave, workers' compensation and other benefits based upon any recomputation in their hours of work and pay. Brice has been consolidated with the above-referenced Marshall suit. No decisions have been issued.

ELECTRONIC MAIL

Question: Last year the Committee spent a great deal of time debating the appropriate role of the Postal Service with regard to electronic mail. Since then the Postal Service has encountered problems with its contractors, the Postal Rate Commission (PRC) and the Federal Communications Commission. Additionally, some private enterprises have attempted to halt USPS's efforts in this program. Regulatory, jurisdictional, and judicial proceedings have delayed positive steps in USPS's participation in the electronic mail market. What impact has the regulatory delay with the FCC and the Postal Rate Commission had on your efforts to enter the electronic mail market?

Answer: The original "Request of the United States Postal Service for a Recommended Decision on Establishing an Electronic Computer Originated Mail (E-COM) Subclass" was submitted to the Postal Rate Commission (PRC) on September 8, 1978 by the Postal Service Board of Governors. The PRC submitted its Opinion and Recommended Decision to the Postal Service Board of Governors on December 17, 1979. The Board rejected the decision on February 22, 1980, on technical grounds, but asked the Commission to make several modifications that would make it acceptable. The PRC returned their "Opinion and Recommended Decision Upon Reconsideration" to the Postal Service Board of Governors on April 8, 1980.

A contract for E-COM service was signed with Western Union on August 21, 1978. Western Union also had to file for a tariff to provide E-COM service to the Postal Service, which they did on January 8, 1979. This Western Union request was rejected by the FCC on April 6, 1979. As a result of further delays occasioned by regulatory disputes concerning jurisdiction over E-COM, Western Union withdrew from the contract in December 1979.

With regard to International Electronic Post (INTELPOST), in August, 1979, two International Record Carriers (IRC) submitted requests to the FCC for circuitry approval for INTELPOST. These requests for tariff changes for INTELPOST circuits were rejected in November 1979 by the FCC. Appeals were lodged with the Commission by the Postal Service, National Telecommunications and Information Administration and the two International Record Carriers. These appeals were also rejected by the Commission in April, 1980.

In the case of E-COM, contract arrangements had been made with Western Union and live service could have begun as early as November, 1978. In the case of INTELPOST, the system equipment was in place and had been tested by the Postal Service here and in Great Britain. We were ready to go into a live mail service in August, 1979.

The regulatory delays detailed above have prevented the Postal Service from entering into a live mail situation and gaining the attendant technical and marketing experience that these service offerings would provide.

Question: Do you believe that USPS will be able to overcome these obstacles?

Answer: Yes. We are confident that ultimately the various regulatory obstacles will be overcome. The reason for this confidence is we are satisfied that through customer contacts and appraisal of the market situation, there is a need for the coupling of our nationwide universal delivery and retail system of post offices with access to telecommunication messages to serve all of the Nation. This market demand is based on the efficiency and high speed with which messages may be transmitted electronically, coupled with our nationwide delivery service, to provide electronic mail service to all, including households and small businesses.

In addition to the obvious service benefits through use of an electronic mail service system, all of our studies and evaluations assure us that the cost of processing, transporting and sorting messages through the present system can be significantly reduced through the automation potential of electronic mail. These efficiencies, in turn, will enable the Postal Service to pass such cost reductions on in the form of a stabilized rate structure for our customers.

Question: What will be the impact on the postal operations we know today if the USPS does not become actively involved in the electronic mail market?

Answer: Forecasts and estimates of potential volume for EMS in the Postal Service mailstream in the 1980 era vary from a pessimistic 10 billion pieces per year to estimates of 25 to 30 billion messages per year. If this volume were to be diverted, in total, to other communication forms due to the noninvolvement of USPS in EMS, then the impact could be a negative 25 billion pieces of what we now handle as letter mail.

In the handling of hard copy letter mail under its contemporary operation, the Postal Service expends 86% of its total resources on the labor necessary to handle the huge volume. This, in turn, is translated into rates which must be charged to our customers to meet the "break-even" requirements of the Statutes. Without the potential efficiencies of EMS we might expect decreased volumes - as noted above - with continuing high overhead costs. This, in turn, would necessitate transfer of these higher costs into higher rates, thus assisting in a cost/rate spiral that would be detrimental to our customers and to the competitive status of the Postal Service in providing communication services.

Question: What will be the costs involved with such impacts?

Answer: Cost estimates, of necessity, must be based on the assumption of volume impacts of mail diverted to EMS over the next 10 to 20 years. Based on our major planning studies, however, it has been estimated that conventional mail processing costs (in 1978 dollars) 6 cents for handling each letter in the processing operations versus an estimated 2 cents per letter in an electronic system for similar operations.

A further estimate of the cost impact would be the revenue loss that could be estimated if the forecasts of up to 25 billion pieces of letter-size mail were diverted to non-Postal-associated EMS systems by 1990. The loss of that volume of mail, with the related revenue, would still require, under the inflated cost estimates of the 1990 era, continued overhead costs for a full nationwide delivery and Postal retail system. Therefore, lost efficiency, continued overhead, high manpower-utilizing services, and lost revenue could have a staggering effect on the total Postal service and rate structure.

Question: Estimates vary considerably as to what impact on the labor force USPS's participation in electronic mail will have. What estimate do you use for these job losses and what are you doing to reduce the impact on employees and operations?

Answer: Estimates as to the impact on the Postal labor force depend upon the role of the Postal Service in an Electronic Mail Message System. The worst case situation, with regard to the labor force, would be non-Postal Service participation in EMS with a full volume diversion in the 1990 era of 25 billion messages - presently being handled as first class letter mail. This worst case situation could result in excess of 100,000 fewer work years being required to provide service as compared to a baseline situation, with a continuation on a no-change basis, of current Postal Service activities.

Such an estimate could be expected to occur in the 1990s decade if present market and technology assumptions are correct. Thus, we could expect a period of 10-15 years in which these changes might occur. Separation rates (for all causes) in the Postal Service over the past 5 years have varied from a low of 14 1/2% to a high of 18%. Therefore the Postal Service should be able to adjust its labor force with only moderate impacts should the Service find itself with no role in EMS. Overall impacts could be adjusted, but obviously there would be localized impacts where adjustments would be quite difficult. This would be particularly true in the big cities where diversion of volumes to EMS might be expected.

The impact of localized bases would be lessened through out commitment to the labor force in the training of those employees qualified to assume different skills and tasks as might be related to the high technology involved in a Postal-operated EMS.

Question: Last year you described your long range Electronic Message Service System (EMSS) and indicated that initial operation should begin in the mid-1980s. What is the current status of this project and do you now have a more precise target for initial operation?

Answer: We are behind, as described above, on E-COM and INTELPOST by approximately 12 to 18 months. The market and operating experience from these two initial electronic mail services have suffered since we are yet to offer them to the public. Inhouse development activities on our long range Electronic Mail Service System (EMSS) are on target and barring further regulatory experiences, we still plan for initial operation of a 15-city modern, high speed electronic mail service by the mid 1980s. This will be the initial phase of a nationwide electronic mail service. Further design and growth will be responsive to customer demand.

Question: Has the USPS done any more market analysis to determine what electronic mail services the public wants or how large the customer market is?

Answer: Yes, several studies have been made. We are currently finalizing a Technical Requirement Survey contract activity which lasted over a year. This survey interviewed top officials in three principal areas namely, mail users, mail electronic equipment manufacturers, and communications providers. In order for an electronic mail system to be acceptable for use by mailers, it must be compatible with equipment and media in general use. The purpose of this study contract was to establish current usage and to forecast for the 1985-1990 period how customers may use modern electronic mail systems. It was planned that E-COM and INTELPOST would also provide valuable market data, but delays to these programs have prevented us from benefitting from a valuable source of market data. Plans are currently being made to conduct additional market studies to keep up with changing customer needs.

We believe that a low cost, high volume, quality electronic mail service tied to our nationwide universal distribution and delivery service has wide market appeal.

Question: What have been your prior and current expenditures for EMSS, ECOM, and INTELPOST. What are your estimates for future expenditures?

Answer: Expenditures of our long range development program planning for a full USPS-Electronic Mail Service System totaled $10.2 million from 1973 through 1977. Expenditures for this program were $3.2 billion in FY 1978 and $4.5 million in FY 1979. We expect expenditures on this program to total $8 million in the current fiscal year and, if we proceed to the development of a full System Validation Test Network, we would expect to expend $13.4 million in FY 1981.

Expenditures for the International Electronic Service System (INTELPOST) totaled $.2 million in FY 1978, $1.3 million in FY 1979, and our expected cost in FY 1980 is $.4 million. Expected expenditures in this account for FY 1981 will depend upon some conclusions on regulatory issues to enable the Postal Service to proceed with both INTELPOST communication services and rate income from marketable services.

There have been no contract expenditures for E-COM and only normal administrative overhead costs have been incurred since the program has never gotten under way and the prime contractor - Western Union - has withdrawn from the arrangement with the Postal Service.

OPERATING EXPENSES; TRANSPORTATION UP 20.5% REGIONAL OPERATIONS UP 21.4%; CAPITAL INVESTMENTS UP 29.6%

Question: Domestic airmail costs have increased significantly in the past several years. Your 1981 budget estimates the cost at $508.6 million (P. III-27) -- a 70% increase over 1979 and a 35% increase in the past year. Expenses for other transportation modes show relatively normal increases. We recognize that fuel costs have risen markedly, but passengers air fares are relatively stable, and in some cases lessened.

Why have your domestic airmail costs increased so sharply?

Answer: The question as stated requires a two-part answer. First, why have domestic airmail costs increased so sharply? And, secondly, are domestic airmail rates increasing at an abnormal rate as compared to other air traffics, particularly passenger fares?

In response to the first question, domestic airmail costs increased sharply as a result of significant fuel cost escalation and a change in CAB methodology for establishing airmail rates.

Prior to FY 1980, domestic airmail rates were established through lengthy evidentiary hearings conducted by the Civil Aeronautics Board. Final airmail rates established by the Board were for annual periods and reflected cost escalation factors based on relatively old historical cost increase data.

In December, 1979, however, the Board issued an order which established an automatic quarterly update procedure for airmail rates in view of rapidly escalating air carrier fuel costs. The quarterly rates reflect cost projections based on more recent data than did the traditional Board method used before FY 1980.

Secondly, it is not true that current passenger air fares are relatively stable. Despite the availability of a limited number of passenger discount or promotional fares, overall passenger fares increased 33% in calendar year 1979. (Aviation Daily, March 26, 1980, page 141) As in the case of mail rates, these increases are primarily attributable to rapidly escalating fuel costs.

Question: Is there a continuing shift of mail volume from surface to air, or have the rates increased?

Answer: Rates have increased.

ESCALATING COSTS FOR WORKERS' COMPENSATION

Question: A major item of expense for the Postal Service has been workers' compensation. Workers' compensation expenses have steadily increased over the years since Reorganization. In 1980 the accrued expense was $750 million and the 1981 budget estimates $1.1 billion -- an increase of 47% over the previous year. The outstanding liability for workers' compensation is projected to be $3.6 billion by the end of 1981. Why was there such a sharp increase in the provision of this expense in 1981?

Answer: During Fiscal Year 1979, the Independent Actuarial Services of Connecticut, Inc., the firm engaged to examine the estimation model for workers' compensation claims, and GAO recommended refinements in the techniques for predicting the variables which determine the workers' compensation liabilities. These refinements reduced the liability by about $250 million thru Fiscal Year 1979, and consequently, were reflected as a reduction in the workers' compensation expense for Fiscal Year 1980.

The original 1980 estimate for Workers' Compensation expense was $1.0 billion. This estimate was revised to $750 million due to the effect of changes proposed in the estimation model. The $250 million charge against the liability is a one time occurence. Therefore, the expected increase in the expense from 1980 to 1981, before model changes, is only 10%.

Question: Without a contingency fund how do you expect to pay for the accrued cost in future years?

Answer: The Postal Service, while not specifically designating a fund for workers' compensation as such, is currently recognizing future liabilities for workers' compensation claims and records the estimated future liabilities in the financial statements accordingly.

The liability for workers' compensation is acknowledged by reporting the estimated liability in the credit side of the balance sheet, which in effect, reduces equity that could be used for other purposes.

As a going concern, the Postal Service has the ability to vary and control its revenues and expenses in the future and can forecast annual cash payments as part of its total economic strategy. Our internal budgetary process and cash planning includes the annual estimate of the cash payment required for workers' compensation and therefore provides for these costs as they become due.

Question: What impact do you see the cost of the program having on future postal rates?

Answer: The Postal Service records as an operating expense in the year of injury the discounted present value of the total estimated cost of a workers' compensation claim. It is assumed that all future payments on a particular claim will be made at the current year price level. As the general price level increases, an inflationary cost is recognized on the current year payment plus the remaining estimated future payments for one year. This limits the effect of inflation, to some extent, to the respective period. Accordingly, future inflation costs are borne by future ratepayers, and predicated on current projections of inflation, we anticipate that the cost of workers' compensation, which was 4% of the total operating expenses in Fiscal Year 1979, will continue to be a significant factor in postal rates for the forseeable future.

Question: Do you expect costs to continue to rise in the future and if so, what are you doing about it?

Answer: We expect that workers' compensation costs will increase at or near the rate of inflation for the next several years. In an attempt to control our workers' compensation costs, we have reemphasized our safety rpogram and developed comprehensive procedures for the administration of this program. Over 300 full-time employees are involved in the administration of this program for the Postal Service.

In addition, a Special Assistant to the Deputy Postmaster General has been appointed with the responsibility of coordinating the Postal Service's activities with the Department of Labor. The Special Assistant will have substantial liaison contact with officials in the Department of Labor and undertake studies and analyses leading to recommendations on program improvements.

Question: You are requesting $37.1 million in 1981 to cover the non-funded compensation liabilities of the former post office department for injuries occurring before July 1, 1971. In the statement provided for the hearing record last year, it was stated that after an evaluation by the Postal Service and Labor Department you expected to finalize in 1979 a new policy and program dealing with long-term compensation cases. Has this new policy and program been put into effect? Please explain it.

Answer: The Postal Service and the Department of Labor implemented a joint Rehabilitation Program in October 1979. The purpose of this program is to identify former postal employees on the Department of Labor's long-term compensation rolls and return them to productive work within their medical limitations. A review of over 11,000 case files has disclosed the potential reemployment of approximately 55% or 6,000 former employees if the program is fully implemented by both agencies. The program is now fully operational in our five regions. We anticipate that it will take two years for the full potential of the program to be realized.

CITY DELIVERY CARRIERS EXPENSES

Question: The numbers of city carriers have dropped steadily. since 1979 - 2,243 in 1980 and estimated at 1,058 in 1981 for a total of about 3,300 carriers (IV-4). However, the number of city delivery letter routes and deliveries are increasing (IV-6) and salaries and benefits of city delivery carriers are increasing (III-20). What is the explanation of this apparent anomaly?

Answer: This apparent anomaly may be attributed to one of two causes or a combination of both.

A. There was probably an overstaffing situation. Tighter complement controls which originated with budget calls for FY 1980 resulted in the reductions noted.

B. Reduction of employees on continuation of pay (COP) rolls due to injuries. Between 1977 and 1979, employees on COP rolls have decreased from 41,000 cases in '77 to 38,000 cases in '79. Normally 40 percent of the employees on COP rolls are delivery employees.

Question: Has there been a cost reduction in city delivery services. If so, has that cost shifted to another class of employees?

Answer: Cost per carrier work year is expected to increase due to the cost of living clause in our agreement with the craft unions, which remains in effect through July 20, 1981.

Questions Submitted by Senator Magnuson

Question: Over a year has elapsed since the Civil Aeronautics Board's order eliminating equalization of airmail rates between the West Coast and the Orient. What steps has the Postal Service taken to realize potential savings under the new airmail status?

Answer: By agreement between the DOD and USPS, an additional twelve percent of the military mail was to be airlifted to Seattle rather than to San Francisco at the outset. The reason for a limitation was to avoid possible deterioration of service. However, the military substantially increased the amount of mail to Seattle starting in February without regard to service and USPS costs. USPS plans to develop routing instructions jointly with the military to restore a more balanced flow of mail and to avoid further service deterioration.

Question: Has the Postal Service taken significant steps to increase use of the Seattle gateway for outgoing military mail? If you have not done so, elaborate why not?

Answer: No significant steps have been taken to increase the use of Seattle for outgoing military mail because of the predominance of air service from San Francisco. In addition, the greater percentage of mail to the Pacific area originates in the southern half of the country. Transportation costs from the southern tier of states is less to San Francisco than to Seattle.

Question: Has the Postal Service estimated the amount of money it can save by using Seattle as its primary port for Pacific mail? Has an estimate been made of the cost of changing the ratio of Pacific mail transported through San Francisco and Seattle?

Answer: No study has been made of civil mail to the Pacific. However, a recent study indicates that if all inbound and outbound military mail was routed to Seattle, the additional domestic transportation costs to the USPS would be several hundred thousand dollars per year. USPS anticipates a similar cost increase would be experienced for civil mail with possible service deterioration. USPS plans to examine these issues after resolution of the questions associated with the military mail gateways.

Question: A January 11, 1980 GAO report entitled, "How Military Postal Service Operations Can Be Improved" notes that the Postal Service should seek solutions to increase the efficiency of Seattle operations since Seattle's military mail volume is low. What steps has the Postal Service taken to implement this recommendation?

Answer: The referenced GAO report made note of the positive impact on service that resulted from two changes on the East Coast for military mail destined for Transatlantic areas; i.e., the creation of multiple gateways and the elimination of unit level distribution. Consequently, the particular recommendation was made to eliminate unit level distribution on the West Coast also. This has been accomplished as a result of the recent DOD agreement. With regard to multiple gateways, the issue is moot since they already exist.

Question: When is the Postal Service going to follow the Defense Department's examples and more fully utilize the Seattle gateway?

Answer: The revised routing instructions will address this issue.

Questions Submitted by Senator Schmitt

REROUTING MILITARY MAIL

Question: We understand that the military mail from the Pacific has been rerouted from San Francisco as a port of entry.

Answer: This is correct. In February the military substantially increased the amount of mail moving to Seattle in lieu of San Francisco. This action was taken without USPS approval or regard to service and cost impacts. While the USPS agreed to a moderate increase, the volume diverted to Seattle was much greater than approved.

Question: What is the exact cost impact for USPS in distributing this mail from Seattle to the final destination within the United States as compared to the former system through San Francisco?

Answer: The additional transportation cost resulting from the distribution of all military mail in Seattle in lieu of San Francisco to final destinations within the United States is approximately $250,000 per year.

Question: What is the additional cost to USPS in personnel?

Answer: A study will not be completed on personnel impact until a more balanced flow of mail to Seattle and San Francisco can be established.

Question: What is being done with the San Francisco USPS employees who have handled this inbound military mail over the years?

Answer: No actions have been taken pending restoration of a more balanced flow of mail to the two facilities.

Question: Are you contemplating a similar change for civil and military mail to the Pacific?

Answer: No, not until service impacts can be identified.

Question: What would be the costs in terms of transportation and manpower of such a switch?

Answer: Manpower costs as previously explained have not been identified. If all transpacific military mail inbound to and outbound from the United States were to be processed at Seattle in lieu of San Francisco, the reduction in international transportation cost to the military would more than offset the increase in domestic transportation costs to the Postal Service. However, air service to and from Seattle is not as frequent as that to and from San Francisco. Therefore service would be adversely affected if most military mail were to be routed via Seattle. The costs and service factors related to civil mail have not been examined.

BOONDOGGLE

Question: In the past year we have discovered the USPS in the "Census" and "Questioning" business. Why in the world did USPS together with the Survey Research Center of the University of Michigan start asking such questions as (A) "The type of activities at a business establishment?", (B) "The race and sex of its ('business') principal managers?", and (C) "Whether its employees participate in ownership of the organization?". Did the Survey Research Center pay USPS to distribute this questionnaire? Did you make any payments to the Survey Research Center? How many of these surveys were sent out and at what cost? Have you or will you terminate this program forthwith?

Answer: The survey in question is a joint effort by the Postal Service and the Survey Research Center of the University of Michigan. Its purpose is to provide an updated sampling frame for "nonhousehold" establishments. Nonhouseholds include businesses, nonprofit organizations, and Federal, state, and local government agencies.

The original nonhousehold sampling frame information was collected almost two years ago, and was subsequently used to draw a probability sample of approximately 6,000 nonhousehold establishments for use in the Nonhousehold Mailstream Description Study, a study performed by the Survey Research Center under contract to the Postal Service. Data on the use of USPS and competitive delivery services were subsequently collected from about 5,000 of these establishments, and will form the basis of the study's final report to be completed in July of this year. A variety of market information never before available from sources inside or outside the Federal Government will be presented in this report.

A number of alternative sources for the original sampling frame information were investigated by the Postal Service and the Survey Research Center before any data were actually collected. As far as Federal Government sources of similar data, it quickly became apparent that only the Bureau of the Census possessed information on various types of nonhouseholds that might be used for probability sampling purposes. Several discussions with Census Bureau personnel were held, and it was decided that their information could not be used to satisfy the requirements of the Nonhousehold Mailstream Description Study for two reasons. First, their policies on confidentiality would prohibit them from releasing their sampling frame information suitable for a study of mail use for all types of nonhousehold establishments.

Discussions also took place about two years ago with Department of Energy personnel, who also had a requirement for a sampling frame for nonhouseholds. They indicated that they would be interested in using the information developed by the Postal Service and the Survey Research Center when it became available. Now that the sampling frame has been completed, several Federal Government agencies, including the National Archives, have also expressed interest in using this information for their own research purposes. The Postal Service policy is to provide this information upon request to the Federal Government agencies on a nonprofit basis.

After concluding that no existing government or commercial source could supply the required sampling frame information, the Survey Research Center developed a procedure for collecting these data which involved the use of Postal Service-maintained records for mailers with significant postal expenditures and listings of nonhousehold establishments prepared by Postal Service carriers. This procedure was implemented in about 150 post office areas across the country and the resulting lists form the original nonhousehold sampling frame.

The recently conducted Survey of Businesses in the United States, toward which Senator Schmitt's specific questions were directed, was intended to update the original nonhousehold sampling frame by taking account of address changes, organizations going out of business, etc. The original survey form was mailed to 168,000 nonhousehold establishments, and approximately 85,000 responses have been received to date. The Postal Service bore only the actual cost, estimated at $45,000, for mailing about 300,000 original and follow-up survey forms in penalty envelopes. All other costs of the survey, including printing and preparation of the mailings, plus keypunching, editing and computer processing of returned forms, were borne by the Survey Research Center. The Center's share of the survey cost will be about $78,000 and this cost will not be passed on to the Postal Service. We have received less than twenty complaints from recipients of the survey form thus far, primarily related to the questions on race and sex of the principal manager of the establishment.

The Survey Research Center has informed us that the questions about race were included for the purpose of beginning the development of a data base for drawing representative samples of two minority groups - blacks and Mexican Americans. The Institute for Social Research of the University of Michigan, of which the Survey Research Center is a part, has two different research groups studying these minority groups. At the present time both of these research groups are interviewing households but their longer-range plans call for interviewing minority businesses. Similarly, the question on sex was included because of the potential to study businesses managed by women, a topic currently under investigation by still another group at the Institute for Social Research. In both cases, the data required for research on these topics are not available elsewhere.

The Postal Service agreed to share the expenses of this survey with the Survey Research Center because of our need to maintain an accurate nonhousehold sampling frame for use in future studies. The Survey Research Center was originally unwilling to enter into this agreement unless their questions on race and sex were included on the questionnaire. At the time of the agreement, it apppeared that the advantages of the joint effort to the Postal Service outweighed the disadvantages. Because of the recent complaints concerning these questions, we subsequently asked, and the Survey Research Center agreed, that all questions not directly related to the sampling frame be deleted. The questions in the survey pertaining to the race and sex of the managers of the establishment were removed from all questionnaires mailed after November 15, 1979. The last revised survey forms were mailed on January 14, 1980.

DEPARTMENT OF THE TREASURY

STATEMENT OF ROBERT CARSWELL, DEPUTY SECRETARY OF THE TREASURY

PREPARED STATEMENT

Senator CHILES. The committee will now receive testimony from the Office of the Secretary of the Treasury regarding the fiscal year 1981 budget request and the fiscal year 1980 supplemental request for the International Affairs appropriation. The committee is pleased to have the Deputy Secretary, Mr. Robert Carswell, with us. We will put your full statement in the record and we would be pleased if you provide us with some highlights of it.

[The statement follows:]

STATEMENT OF ROBERT CARSWELL

I am pleased to appear before you today in support of the FY 1981 appropriation request for the international affairs activites of the Office of the Secretary.

The international functions of the Office of the Secretary reflect the increasingly essential linkage between U.S. international and domestic economic policies. High rates of inflation and unemployment, reduced economic growth, and dramatic increases in energy prices are common global problems which require intensive cooperation among both industrialized and developing nations to promote our mutual economic objectives in today's interdependent world economy.

Our fight against inflation, in particular, must include international as well as domestic policy initiatives. A stable dollar, a fair and open system of international trade and investment, and efforts to stabilize international food and commodity prices are essential aspects of our efforts to avoid additional inflationary pressures. Smoothly-functioning international monetary arrangements are important to the preservation of an open and efficient system of international trade and investment, which are vital to our economic interests and to the maintenance of a strong and competitive U.S. economy.

The Treasury Department, through its international affairs functions, plays a key role in assuring that our international economic policies support the needs of our domestic economy and enhance the economic benefits of our global interdependence. The Secretary of the Treasury has major international responsibilities: he is Governor for the United States in the International Monetary Fund, the World Bank and other multilateral development banks; co-Chairman of the Saudi Arabian-United States Joint Commission on Economic Cooperation; Honorary Director of the U.S.-U.S.S.R. Trade and Economic Council; co-Chairman of the U.S.-U.S.S.R. Commercial Commission; and co-Chairman of the U.S.-China Joint Economic Committee. The Secretary oversees U.S. international monetary policy and operations, represents the United States in discussions and negotiations of bilateral and international monetary and financial issues with other nations, and closely assists the President at economic summit meetings. Treasury's views provide important input in the interagency determination of U.S. policies on international trade, development, energy and commodities issues.

Such activities as these, on the part of the Secretary and other senior Treasury officials, require highly professional staff support. There is a continuing need for knowledge and analysis of economic conditions and policies abroad, for development and representation of U.S. positions at staff level with foreign economic policy activities to the national interests of the United States.

The appropriation we are requesting for the international affairs function is approximately $23.7 million. As compared with the total funding level for 1980, this request represents a net increase in expenditures of $834,000, of which $700,000 represents expenditures to equalize the salaries of U.S. ADB employees. We are also requesting a supplemental appropriation for FY 1980 of $0.2 million to fund approximately one-fifth of the cost of the latest pay increase for U.S. Government employees.

Secretary Miller is deeply concerned that the international affairs functions of the Treasury Department be carried out in as efficient a manner as possible. While our overall international responsibilities have grown more complex and demanding, we have been able to meet our requirements through more efficient use of existing resources and a minimum of expanded budget authority. In 1976, example, we had 555 permanent positions. The request before you today is for 460 permanent positions. The increase in funds requested for 1981 is only slightly less than 4 percent above the authorized level for the current fiscal year.

The nature of the Treasury's international work requires significant foreign travel. This is unavoidable, but we have made major and continuing efforts to reduce travel expenses. Travel expenses in 1975 were $1,326,000. In 1979 we spent $1,033,000 on foreign travel. In 1981, we are requesting $1,057,000 -- or an increase of approximately 2 percent over last year's actual expenses. Inflation and dollar depreciation notwithstanding, we have managed to reduce travel expenses by 20 percent in the last five years.

A program increase of $700,000 is requested to permit us to equalize the salaries of U.S. nationals employed by the Asian Development Bank (ADB) with those of other nationals employed by the Bank. I would like to explain this request.

The Asian Development Bank (ADB) has enjoyed a reputation for prudent policy, effective management and low administrative costs. In part, the Bank's ability to keep administrative costs low has resulted from the relatively low cost of living that used to exist in Manila.

In recent years, however, inflation has placed a severe strain on individuals employed by the ADB. The cost of living in Manila has increased by 70 percent in the last three years, compared to a 32 percent increase in Washington. Housing costs in particular have soared and are now a major deterrent to accepting employment with the ADB. For example, in today's housing market in Manila, the United States Government spends between $25,000 and $30,000 per year to provide a married GS-16 employee, with two or more dependents, with appropriate accommodations. Housing costs are therefore at least twice those of equivalent accommodations in the Washington, D.C. area, and are increasing at a much faster rate.

In addition, ADB staff salaries are established on the assumption that they will be exempt from national income taxes. U.S. citizens are the only expatriates on the staff of the Bank whose salaries are subject to taxes. The 1978 revision of U.S. tax laws regarding foreign earned income has placed these Americans at a severe disadvantage; they now receive, on the average, 20 percent less after taxes than other nationals at the ADB, and 30 percent less than U.S. Government officials in Manila at the same basic rate of pay.

These problems have made employment with the ADB a serious hardship for the U.S. nationals already there, and has made recruitment of qualified U.S. citizens almost impossible.

During 1979, eleven Americans [illegible] of 31 resigned from the ADB, and other resignations are expected in the near future. There are now only five Americans, out of a total of 54, at a level equivalent to GS-16 or above in the Bank, compared to seven from Japan, and 15 from South Asia. Other member countries exert maximum efforts to place their nationals at these levels in all international organizations. If the U.S. presence were to erode permanently, the philosophical make-up of the ADB staff could change. Continued employement of U.S. citizens on the staff of the ADB is of considerable policy importance to the United States, as it helps contribute to more effective implementation of ADB policy and projects.

The United States currently has cumulative subscriptions in the Bank of over $1.3 billion, and contributions to the Bank are growing by several hundred million dollars each year. Congress has long urged employment of U.S. nationals on the staffs of international organizations, and provides similar salary adjustments for U.S. citizens employed at all U.N. agencies through appropriations to the Department of State.

Other changes in the budget include an increase of $1,558,000 to maintain current levels of operation in Office of the Secretary international affairs activities. These funds will be used to meet the costs of communications services ($22,000), within-grade salary increases ($140,000), printing costs ($9,000), space rental costs ($16,000), payments to the Working Capital Fund ($32,000), support services ($232,000), 1980 pay raise annualization ($628,000), pay increase and cash awards for the Senior Executive Service program ($345,000), and travel cost ($134,000).

These increased requirements are partially offset by expenditure reductions totaling $1,424,000. Included in these are increased productivity ($634,000), [illegible] less pay day ($60,000), reduced building maintenance support for overseas operations ($98,000), annualization of the FY 1980 position transfer to the Office of the U.S. Trade Representative ($32,000) and an across the board reduction as part of the President's amended budget request ($600,000).

In addition to the budget request for 1981 which I have outlined, we are also requesting a supplemental appropriation for 1980 in the amount of $199,000. This represents approximately one-~~half~~ fifth of the total cost of the October 1979 pay raise for government employees. We have absorbed as much of the increased cost of salaries as possible within existing resources, and need increased funding for the remainder.

This concludes may statement, Mr. Chairman. I will be pleased to answer any questions that you or members of the Subcommittee may have.

ASIAN DEVELOPMENT BANK SALARY EQUALIZATION

Mr. CARSWELL. It is a pleasure to be here, Mr. Chairman. I think this is a relatively routine request. There is nothing unusual in it, except for one item relating to the Asian Development Bank, involving $700,000. That is a payment to make up for an unusual situation in that Bank.

The cost of living in Manila, where the Bank is located, is expensive today. In all the other major international organizations in which the United States is a member, Americans, who are on the staffs of these institutions, receive salary equalization payments of one kind or another, to bring their after-tax incomes into line with those received by staff from other countries.

That is not true in the Asian Development Bank. The result is that on the staff of the Asian Development Bank only Americans and Filipinos pay tax. Effectively therefore, Americans on the staff of the Asian Development Bank receive on average less than 78 percent of the salaries that are received by a Japanese or a United Kingdom citizen. Since the competitiveness of Bank compensation assumes that the Bank salary will be tax-exempt, it is hard to hire Americans because they are in effect receiving 20 to 30 percent less than what is deemed a competitive salary.

In addition, in the Philippines, U.S. Government personnel who are serving in the Embassy, receive housing allowances that cover all housing costs. This is important because housing in the Philippines costs at least twice as much as housing in Washington, D.C. Those housing allowances have the effect of making the disposable income—after taxes and housing costs—of the U.S. Govenrment personnel serving in the Philippines some 30 percent higher than the people who work for the Bank.

I was out there about 1½ years ago at an annual meeting of the Bank and I can say that there is no question, and I talked to all of these individuals involved, but that we are losing the better ones and the Bank is unable to hire higher caliber U.S. citizens because the after-tax salary levels are simply not competitive for Americans.

The question that is raised is whether as a matter of national policy we want to have our nationals on the staff of this Bank. I would suggest we do, since we are putting up in the range of 16 percent of that Bank's capital. Since our level of procurement from the ADB is the lowest of the regional banks, it is important that we have U.S. citizens on the staff who understand what U.S. industry produces and can look at those projects in a somewhat sympathetic way, at least to assure that products of American firms get the same opportunities as those from other countries.

The present situation is important. In the last year something like one-third of the U.S. persons on the staff of the Bank have left and they are not being replaced by comparably qualified staff. This request is a relatively small amount to correct what I think is an undesirable condition. It doesn't make any sense given the level of U.S. investment in that Bank and the resulting lack of influence that I am afraid we have on the staff.

It is a small item, but that is the only nonroutine item that is in the budget this year.

Senator CHILES. I think the greater problem, of course, is the continued disenchantment of the American taxpayer in supplying all of these Bank employees, while we pay their taxes. We don't pay your taxes, we don't pay mine. We don't pay anybody's in the military. Why do we allow this to be set up to start with? We had a lot to do with chartering these Banks, how they are set up and we know that it is the fattest job that is on the pike.

We know that many people will go in and out of the governments, especially a lot of governments, they go to the Bank, if their party gets in power, they go back in power, if the party gets out of power, they go back to the Bank. You know, I see a lot of my good friends from the Latin American countries and I know when they won or lost the election depending on when they are with the Bank or not, when I meet them at the Embassy or when I meet them in the Bank job.

Why is that? Why do we have that policy at all and why haven't we done something about it?

Mr. CARSWELL. I would suggest first we have done something about it and I will come back to that in a minute. That is why I tried to point out that you can look at it in two ways in Manila. The fact is our Air Force, our military people in the Philippines and our Embassy people in the Philippines are paid at a rate roughly 30 percent more than the Bank people primarily because of the housing differentiation. The ADB is not a cushy job.

Senator CHILES. Well, I am not sure. They may get a housing allowance, but I venture to take you to task that they are getting 30 percent more if they are military people, military pay.

Mr. CARSWELL. They don't get it in the take-home pay, but they get a house.

Senator CHILES. That is what we are talking about, the ultimate, what their drawdown is.

Mr. CARSWELL. They don't pay for the house. They get it on the base, or in the case of the Ambassador, he gets his house and in the case of the various other people on the Embassy staff there, they do get housing in the Philippines or they get an allowance that is by local standards enough to have a comparable house. That is not provided to the Bank.

All I can say is if you look at what an American who has comparable experience gets paid, when he works for the U.S. Government, you compare that to the way he is able to live, either through a housing allowance or Government-supplied quarters, the Government employee is better off than the American working for the Bank.

Anyway, the net of it is clear. We just don't have a sufficient number of good people on the staff of that Bank. They are leaving.

The second part of it obviously is that there have been, as far as I am concerned in the past, mistaken policies regarding compensation of the staff and executive directors in some of the other Banks. We have made an effort, as you know, in recent years to do something about that and at least as far as the American executive directors are concerned in those institutions I think the situation is now different from what it was and the abuses of the past I think are over.

But there is no question that years ago that was a problem.

OVERLAP OF ACTIVITIES WITH STATE AND COMMERCE

Senator CHILES. Going now to the overlap of activities with State and Commerce, the justification material as well as Department Order 108–1, defines the functions of the Office of International Affairs, and talks about the international affairs activity in broad terms. Generally the office is devoted to formulating and implementing Treasury positions and policies on a wide range of international matters over which Treasury typically has no direct control.

Most of these functions and activities are also addressed by other Federal agencies, particularly the Department of State and the Department of Commerce. I wonder if you could clarify for the committee the role that Treasury plays in in international affairs as opposed to State and Commerce and other agencies?

Mr. CARSWELL. You will have to bear with me. The only way I can do it is to know specifically what those areas are. I can do it very quickly, but I can't answer in generalities.

The largest single number of people and resources in the international area of Treasury is in the Office of Developing Nations and basically they supervise the U.S. activities in those Banks; that is, the World Bank, the Inter-American Development Bank, the Asian Development Bank, and the African Development Bank. Those are 81 people.

That is a pretty small number for the AID agency's work in these areas and, you know, for the equivalent of what the AID agency does. We look at all of those projects through the Treasury. That is the biggest number.

The second largest number is in the area of international monetary affairs where there we have 69 people in Washington, about 30 people overseas as Treasury attaches at one time or another. There again, the Secretary of the Treasury is the Governor of the International Monetary Fund and has direct responsibilities in that whole area.

Those people also handle our exchange market operations, they also are involved in the direct monetary negotiations that we have around the world. They are the major resource for preparing international monetary policy statements and the research needed for the Secretary of the Treasury; and they interpret and make our balance-of-payments policy.

Again, I don't know of any significant overlap there with any other agency. We are the primary in those two areas.

The third largest is in the area of international economic analysis. That is basically a statistical operation. There we collect certain types of foreign portfolio information; we collect the data for the survey on foreign portfolio investment in the United States. We also collect other investment information in careful coordination with the other agencies, particularly Commerce which collects another large part of it.

Again, I am not aware of any particular overlap. You could put the two of them together, but you would have the same number of people, and, because it is the foreign investment area, it has been felt that that is an area that Treasury ought to have some part of, at least by the people who passed the legislation.

They just finished again, as you know, making us do another study and that resulted in us having to take on 25 more people in this area.

The fourth area in size is the area of trade, certain parts of direct investment in the United States, our relations with the U.S.S.R., our relations with the People's Republic of China, and our relations with Eximbank. There are 33 people involved in that.

Again, the Treasury Department has the major responsibility in the U.S. Government in most of that area—not for trade, but again it is a relatively small number of people involved in trade.

The next smallest area is the area of commodities and natural resources. The Treasury's activities in the international energy field are in that part. This comes up at every summit meeting. It has for the last 5 years. The Secretary of the Treasury inevitably is involved in the Middle East energy problems, has had a leadership role for many years in the area.

In addition to that, we have to negotiate, we are involved directly in negotiations with others in the commodity agreements, which are normally handled in other countries by the Finance Ministry, and our people inevitably are involved in it. There are 28 people involved there. Again, there is very little overlap when you think of the fact that the Secretary of the Treasury has the primary role. But we are getting down to very small numbers.

The next is 22 people who are working directly for the Assistant Secretary for International Affairs, most of them are administrative. Frankly, we have a lot of mail, a lot of stuff coming through there and the biggest bulk of those are in secretarial and clerical operation. From then on, you are below 10 in numbers in any spot and mostly clerical.

So all I would say is in gross, the Treasury is spread out on many issues that other agencies may have parts of. But this operation is not heavily staffed considering the wide range of activities that we do participate in and the fact that we have no ancillary responsibilities but primary responsibilities in most of them.

Senator CHILES. I will have some other questions for the record.

Senator SCHMITT. Mr. Chairman, we will have some questions for the record.

TRADE WITH THE SOVIET UNION

Mr. Carswell, are we changing our approach to trade with the Soviet Union in any significant way?

Mr. CARSWELL. I think, clearly.

Senator SCHMITT. Are we looking at the lessons learned in the past? Is there any systematic effort to do that? What trade did we allow that may be coming home to haunt us? Ball bearings, trucks?

Mr. CARSWELL. I don't know—obviously, I hope we all learn from the past.

Senator SCHMITT. Are we systematically looking? We don't have a trade embargo. That means some things are still going to be allowed. Right?

Mr. CARSWELL. We have had since Afghanistan limited, but relatively effective embargo.

Senator SCHMITT. That is their position.

Mr. CARSWELL. That is effectively what it has been for 5 months now.

Senator SCHMITT. Have you used those 5 months to prepare for the future?

Mr. CARSWELL. Yes, absolutely. The President has announced——

Senator SCHMITT. What have you done? We are not talking about the President's budget so much as we are now talking about yours. What has Treasury done to prepare for a different climate of relationships, trade relationships with the Soviet Union?

Mr. CARSWELL. Basically, the lead role in the export control area is Commerce. Treasury has two people working on Soviet matters. We have an Office of East-West Economic Policy which covers the U.S.S.R., as well as Eastern Europe and China. We are not really the primary——

Senator SCHMITT. What do you do? Why do you have anybody?

Mr. CARSWELL. Because the Secretary of the Treasury is the Chairman of the Joint U.S.S.R.-U.S. Commercial Commission which was created in the détente period and which seeks to expand trade within the existing climate and legal structure. The people who do that are two in number. They also represent the Treasury Department and the Secretary of the Treasury in the reexamination of U.S. economic policy toward the U.S.S.R. and they help in coordinating the CoCOM negotiations to the extent we participate in them. They are there to do it.

We sometimes become involved because different countries, CoCOM business is handled in the finance ministeries. Some of it isn't. But again, the Treasury Department resources devoted to this are really not very large.

Senator SCHMITT. The Secretary's function is Chairman of that group, basically a paper function now?

Mr. CARSWELL. Yes; the group was put into recess. It agreed that the U.S.S.R.-U.S. Commercial Commission would not meet this year. They were supposed to have a meeting in April. That was canceled. It is now on ice.

Senator SCHMITT. So, we really are not spending any time or personnel on analyzing the past, present, and future trade relations?

Mr. CARSWELL. No; quite the opposite. In the Treasury we are participating in the administration review of the whole area and there have been a number of meetings, analysis, changes in policy, position papers, and so on.

Senator SCHMITT. How many full-time people are in the Treasury, are working on that?

Mr. CARSWELL. Two full-time persons. It takes a great deal of effort to cut off the trade relations ostensibly as well as to increase trade relations and those people are working very hard since Afghanistan.

I forgot to say to you, Senator, that the major work is highly classified. We would be happy to speak about it in an executive session.

Senator SCHMITT. Thank you, Mr. Chairman.

Senator CHILES. We will have some more questions for you.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR CHILES

Question: Why do we need to continue an International Affairs function at Treasury?

An example of overlap between Treasury and State is the fact that both departments assign economists to certain overseas posts:

Number of Economists Employed By

Overeas Post	Treasury	State*
Bonn	4	3
London	4	4
Mexico City . . .	2	1
Ottawa	2	1
Paris (OECD) . . .	3	9
Rome	6	6

* Includes only international and financial economists.

According to GAO these individuals have very similar responsibilities as evidenced by their job descriptions and are all integral members of U.S. Embassy Staffs. Why is it necessary for both Treasury and State to have staffs at these posts?

Answer: International economists from the Treasury Department's Office of International Affairs form the nucleus of a Financial Unit in the Embassy's or Mission's Economic Section. They serve as integral members of the country team performing the specialized macro-economic, monetary, financial and balance of payments analysis and reporting requirements for which they are specifically qualified by education and professional experience. Treasury with the concurrance of the State Department only assigns economists to U.S. Embassies in those countries which have high developed financial sectors, play a significant role in international financial affairs and/or have significant financial and exchange market relationships with the United States
In recent years, as international economic interdependence has become an area of

increasingly high level policy concern between the governments of the major free world economies -- evidenced by the annual Economic Summit, at the head of government level -- the role of the Treasury economists in major U.S. embassies abroad has taken on added importance. They are not only the most experienced full time international macro-economic analysts on the Embassies' staffs, they are also the primary working-level link between the U.S. Treasury and the foreign finance ministries who are largely responsible for major elements of the greater policy coordination of economic and financial policy mandated at Summit meetings.

While job descriptions of several officers assigned to our Embassies abroad from State, Treasury and other agencies fall in the category of "international economists," in actual fact, in those large Embassies identified, the range of U.S. economic interests and responsibilities is so large and diversified that the individual economists are each responsible for discrete areas of concern in the broad economic area, be it agriculture, trade, commercial policy, minerals, energy, or in the case of Treasury, -- macro-economic policy, monetary, financial balance of payments and foreign exchange matters. These specific areas keep the incumbents fully occupied with the total range of duties associated with each position so that overlap and duplication does not occur. In fact, the full integration of the Treasury economists in the foreign posts' Economic Section ensures that they do not duplicate the work of any other element in the complement of the post.

The example comparing the State and Treasury economists at overseas posts is inaccurate on the Treasury positions. The number of Treasury economists at these overseas posts are as follows: 2 at Bonn, 2 at London, 1 at Mexico City, 1 at Ottawa, 2 at Paris OECD, and 3 at Rome.

APPARENT DUPLICATION IN DEVELOPING NATION'S PROGRAMS

Question: Treasury's developing nations program is responsible for analyzing local economic conditions overseas. The State Department, AID, and various international organizations that we support also perform such analyses. Why can't Treasury rely on State and AID or other sources for this analyses?

Answer: Treasury attaches are only present in a very limited number of developing nations. In such cases they are an integral part of the economic section of the Embassy, and assume responsibility for part of the economic and financial analysis and reporting requirements for which they have particular expertise. In those few countries bilateral economic and financial relationships within the U.S. are complex and there is a need for specialized knowledge of such matters as the effect of developments in those countries on the international monetary system, world capital markets and world develoment prospects, and of the effects of world developments on the economies of those important countries. Thus, the work of the Treasury attache is complementary to that done by State Department personnel in the joint economic section.

Question: How do these activities relate to similar programs at State, Commerce, and the Export-Import Bank?

Answer: It does not overlap that of representatives of Commerce, who have their own field of specialization in promoting U.S. trade and providing services to U.S. traders and businessmen. Export-Import Bank does not maintain representatives overseas, but sometimes Treasury representatives assist the Bank with regard to certain aspects of the Bank's export credit activities.

Question: How many employees does the Department maintain overseas with regard to its developing nations activity?

Answer:

Post	Authorized
Manila	3
Abidjan	2
Brazilia	2
Mexico City	2
Jidda	2
Total	11

LACK OF TANGIBLE OR MEASURABLE OUTPUT FOR THE OFFICE OF INTERNATIONAL AFFAIRS

Question: The International Affairs activity is responsible for "formulating and implementing Treasury positions and policies" and the output seems to be "studies and recommendations" mostly for use by the Secretary of Treasury or other Treasury officials.

Mr. Bergsten, in view of the rather intangible output of your office and the fact that other departments and agencies also have capabilities and programs in these same areas, what is the taxpayer getting for the $23 million we are spending on your office this year?

For example, we talked about the developing nations program earlier. What tangible output or value has the taxpayer received from this program over the last year?

Answer: The staff of the International Affairs activity does prepare a large number of studies and recommendations for Treasury use by the Secretary and other department officials. These studies and the thorough economic and financial analysis which must underlie their recommendations are essential if the Secretary and departmental officials are to carry out their responsibilities in the international field.

The international research staff, in a recent period, collected data dealing with portfolio investment flows into and out of the United States, calculated steel trigger prices, prepared forecasts for balance of payment trade and current accounts and analyzed macroeconomic policies being followed by other industrial countries. These questions all bear importantly on the health and well being of the U.S. economy and clearly affect the choice of policies which we must develop to cope with current economic problems.

The Treasury Department is also responsible for managing U.S. participation in the International Monetary Fund and the multilateral development banks. The work in these areas is necessarily more operational since the international affairs staff must provide direct support and backstopping for U.S. representatives at these institutions on a broad range of international economic issues.

In the multilateral development banks, Treasury staff review all loan proposals made by bank staff and make recommendations dealing with developmental policies, budgetary proposals and financial operations as well as capitalization and replenishment proposals. Two of the banks are located overseas and Treasury Department representatives are assigned to their headquarters on a permanent basis while others are assigned to the headquarters of the institutions which are located in Washington.

The other principal aspect of work in Developing Nations Finance, since you mentioned that particular program, is the monitoring of economic developments in major developing countries of importance to the United States including Mexico, Brazil and Saudi Arabia. In addition, the Treasury Department's international staff have an important role to play in the Joint Economic Commission for the United States and Saudi Arabia.

$700,000 REQUESTED FOR SALARY EQUALIZATION PROGRAM FOR U.S. EMPLOYEES OF THE ASIAN DEVELOPMENT BANK

Question: As I understand it, U.S. citizens employed by the Asian Development Bank are the only group of bank employees whose salaries are subject to their own national taxes and, therefore, the American employees receive approximately 20% less (after taxes) than do other nationals employed by the bank. The $700,000 requested is to equalize the U.S. staff salaries. Is that correct?

Answer: Salaries at the ADB are determined in the first instance on the assumption that they are free of national income taxes. Only U.S. citizens, among the expatriate staff, are liable for national income taxes on their Bank salaries. (Filipinos are also liable for national income taxes on their Bank salaries).

Accordingly, U.S. citizens are estimated to be over 20 percent worse-off, on average, than their colleagues from other countries. In individual cases this gap can be much larger than 20 percent. The gap is expected to increase for all staff as higher salaries caused by the high rate of inflation in Manila particularly for housing costs, push U.S. staff into still higher tax brackets. The requested funds are designed to bring the compensation received by American staff to a level comparable with that received by other expatriate nationals employed at the ADB, and I might add comparable to compensation received by U.S. nationals employed at the Embassy.

Question: These people are employees of the Asian Develoment Bank and they are not Federal Government employees. I am sure they know that they would have to pay U.S. taxes just like every other American citizen when they took on the job. Why then should we essentially pay their taxes for them?

Answer: The U.S. citizens employed by the ADB are not Federal Government employees although several are former United States Government employees on international transfer to the ADB and paid by the ADB with reemployment rights with the Government.

However, the ADB is an international organization created by its member governments. The U.S. investment in the Bank and its concessional window, the Asian

Development Fund, is now $1.4 billion; second only to Japan's investment. The U.S. citizens on the staff are, therefore, working in an organization in which the U.S. citizens at all other major international organizations must also pay U.S. taxes, but they receive additional payments from the organization, financed either by the organization itself or the U.S. Government, leaving them essentially on a par with all other nationals employed by the organizations.

The Americans at the ADB, some of whom joined in the low-tax era, prior to 1976, knew that salaries were taxable. These Americans did not expect that inflation and changes in the U.S. tax law would combine to drastically increase the amount of their U.S. taxes.

The current tax situation also adversely affects the Bank's ability to recruit qualified Americans. We should support this proposal to ensure that qualified U.S. citizens can be hired by the ADB. Our nationals bring to an international organization the cultural values of their homeland.

U.S. staff bring an energetic, entrepreneurial, "can-do" approach to Bank business. In addition, U.S. business has found that there is a long-term correlation between nationality of project design staff and country of procurement, reflecting cultural values brought to the job, education and past experience. Accordingly, without U.S. citizens on the staff, the proportion of procurement from the United States could decline over time, something that neither reflects our national interest nor the wishes of Congress.

COST OF LIVING IN MANILA NOT HIGH

Question: According to the State Department's 1978 indexes of living costs abroad the index for Manila is only 77. Shouldn't the low cost of living help these people make ends meet?

Answer: The State Department index excludes housing and education costs. The latest State Department survey for Manila was January 1979, and showed the index at 89.

Since that time inflation in Manila has run at twice the rate in Washington. Therefore, Manila costs, excluding housing and education, are now roughly on a par with Washington. However, rental costs including utilities can amount to two to three times Washington levels for comparable accommodations. Manila is, therefore, not a low cost city, when all these factors are taken into account.

The evidence of high cost housing is shown by the fact that the United States Government employees in the Philippines are provided with fully-furnished accommodations and sufficient allowances to cover the cost of utilities, while United States citizens employed by the ADB must finance most of these additional housing costs (such as advance rental payments) from their Bank salaries.

Question: Please explain why this problem does not also exist at the IMF, the World Bank, and other international institutions of this nature.

Answer: U.S. citizens employed by international organizations are subject to U.S. income taxes, whether they are working in the United States or not. This situation is virtually unique to this country since most other countries do not tax their nationals when they are working abroad for international organizations.

At all other major international organizations, however, the incomes of U.S. staff are brought up to the level of other nationals, usually through the State Department's budget.

The organizations having systems financed through State's budget are as follows:

United Nations
UNESCO

International Civil Aviation Organization
World Health Organization
FAO
ILO
International Telecommunications Union
IMCO
World Intellectual Property Organization
Inter-American Institute of Agricultural Sciences
Pan American Health Organization
OAS
OECD
The Hague Conference on International Law
GATT
International Cotton Advisory Committee

In the case of the World Bank, International Monetary Fund and the Inter-American Development Bank the compensation of U.S. citizens is made competitive through payments financed by the organizations themselves.

Question: If we initiate this salary equalization program for U.S. employees at the Asian Development Bank won't this unravel the existing situation at the IMF and the World Bank.

Answer: The situation at the IMF and the World Bank is quite different than that of the Asian Development Bank. The Washington-based MDBs have been funding salary equalization, from their earnings, for over thirty years in the case of the IMF and World Bank. We feel that their systems are well-established and we believe the status-quo should be maintained. We intend to maintain the status-quo, if possible.

Question: We understand there is a State-Treasury task force studying the overall problem of salary equalization. When will that study be completed?

Answer: A staff-level inter-agency group, including State and Treasury Departments, has been examining the methods by which salary equalization is funded in the various international organization, of which the U.S. is a member. The preliminary staff opinion is, given the unlikelihood of a change in U.S. tax laws exempting international organization income, that the basic system should remain unchanged, and organizations without an equalization system should be treated on a case-by-case basis. After examining the options, we feel that the salary equalization is essential in the ADB, and the only realistic place in the U.S. budget is in Treasury's own administrative request for international affairs.

Question: Is it likely to recommend that the State Department fund a salary equalization program for U.S. citizens working for the IMF and the World Bank and other such agencies?

Answer: No, the preliminary opinion is that we should continue to examine conditions on a case-by-case basis. We believe the present systems at the IMF and World Bank should remain unchanged. The State Department considers its budget an inappropriate place to fund salary equalization programs for the international financial institutions, since they are not the agency in the U.S. Government ultimately responsible for U.S. participation.

Question: Why don't we wait for the results of the study and approach this problem comprehensively?

Answer: The preliminary study view is that the systems are so varied in detail that a comprehensive rationalization could take years to successfully negotiate and implement. The problems of the ADB are immediate.

Question: The request does not state the number of persons covered or the amount each would receive. What is the basis for the amount of the request?

Answer: We estimate that during calendar year 1979 there were 24 man-years of service by U.S. citizens expected to be on the Bank staff on October 1, 1980. This will cost an estimated $300,000 or $12,500 per staff member on average. During calendar year 1980 there may be an increased number of about 30 man-years of eligible U.S. staff service, costing around $400,000 at present pay rates.

There are considerable uncertainties over these figures, however, since increased recruitment and retention rates could boost the requirement, as could increased pay. On the other hand, a lagging recruitment rate and increased turnover rate would lower the need for funds somewhat, as would a decision that taxes need not be paid on the employer's current contribution to the Bank pension plan.

The figures are based on the estimated taxes paid by Bank staff on their Bank income, bearing in mind that any salary equalization payment received by Bank staff is itself taxable income.

TRADE AND INVESTMENT POLICY

Question: The Trade and Investment Policy Program formulates and implements Treasury positions on many matters including Multilateral and Bilateral trade negotiations. How many average positions were devoted to this subactivity in fiscal year 1979, fiscal year 1980, and proposed for fiscal year 1981?

Answer: About three fulltime positions were devoted to multilateral negotiations (the MTN) and, in general, two to bilateral negotiations (mainly with Japan and with less-developed countries) in 1979. This will be reduced in FY 1980 and 1981 to one position to work on implementing the multilateral trade negotiations, and two to three positions on bilateral trade negotiations.

Question: With the completion of the Multilateral Trade Negotiations, will Treasury activities in this area be reduced? If not, why not?

Answer: With the completion of the MTN, Treasury activities will be reduced in the multilateral area, but Treasury will continue to be involved in bilateral trade negotiations, such as with Japan (autos, Nippon Telephone and Telegraph) and LDCs (most likely with Mexico).

Question: Treasury Department Order No. 108-1 lists 8 areas which the Office has responsibility for. With the possible exception of sub-functions F and H, other Federal agencies including State and Commerce also have similar responsibilities. Does this represent duplication of effort? If not, why not?

Answer: Several agencies of the Executive area involved in policy formulation in the trade and investment area, but this does not represent a duplication of effort. Rather this reflects the view that the United States' trade and investment policy should be made after full consideration of different views and appraisal of the impact of policy options on the nation as a whole. This approach is embodied in the trade legislation passed by the Congress (Section 242, as amended, of the Trade Expansion Act of 1962) which establishes an interagency committee (now the Trade Advisory Committee) to advise the President on trade policy. This same approach is also used for making United States policy in the investment, export finance, and East-West economic policy areas.

Treasury's role in the interagency process of policy formation is essential and unique. Because of the role of the Secretary of the Treasury as economic spokesman of the President and economic advisor to the President, in the interagency policy process Treasry represents a point of view based primarily on the impact on the entire economy and on the balance of payments of alternative international economic policy measures.

Only Treasury has this broad viewpoint; other agencies have more narrow constituencies. In addition, Treasury also makes unique contributions because of its perspective gained from having primary responsibility for international monetary policy and operational responsibility for the international development lending agencies.

Thus Treasury's involvement in the trade, investment, export finance, and East-West international economic policy areas represents not duplication, but the insertion of a broader, more economic, view into United States international economic policy formulation.

	Positions		
	1979	1980	1981
Immed. Office	3	2	2
Int'l Trade	17	15	15
Int'l Investment	7	7	7
East-West Econ. Policy	6	7	7
Trade Finance	5	7	7
TOTAL	38	38	38

COMMODITIES AND NATURAL RESOURCES

Question: How many Commodity and Natural Resources program resources have been devoted to law and sea negotiations for fiscal years 1979, 1980, and proposed for 1981?

Answer:	FY 1979	FY 1980	FY 1981
	$25,500	$24,200	$24,500
	.85 staff-years	.8 staff-years	.8 staff-years

OFFICE OF THE INSPECTOR GENERAL

Question: How many resources are in the Inspector General for international finance area?

Answer: FY 1980 - 4 positions $153,000

Question: Why isn't this activity included in the department-wide Inspector General Office?

Answer: Although the titles are similar the functions are very dissimilar.

The functions of the OASIA Inspector General's office were most recently set forth in Treasury Order No. 108-1 of October 1, 1979:

> The Office of the Inspector General provides the Assistant Secretary and other senior level Treasury officials with a reliable and independent internal appraisal of selected international financial activities and programs for which OASIA has primary operational responsibility. The Inspector General also performs such reviews as requested. Major areas of concern include the efficiency and economy of the use of U.S. investments in the International Monetary Fund, the International Bank for Reconstruction and Development, and regional multilateral banks, as well as procedures governing the use of the ESF.

The basic functions of the Department-wide Inspector General's office on the other hand are described in Treasury Order No. 256, July 18, 1978:

> Receive and analyze allegations of (i) illegal acts, (ii) violations of the Rules of Conduct of the Tresury Department or Bureaus, (iii) violations of the merit system or (iv) any other misconduct (if the matter is one which is not appropriate for normal grievance or appeal procedure or other routine management action) concerning any official or employee of any Treasury office or Bureau.

Question: The budget request for staff of the overseas posts of the Deputy Assistant Secretary for Developing Nations shows an increase of $219,000 or 23% while the number of employees hasn't changed. What is the basis of an increase of this magnitude?

Answer: The increase noted in the question was identified as part of an organizational break-down of International Affairs funding provided to the Committee prior to the hearings. That set of data inadvertently prorated the increase requested for the salary equalization program ($700,000) to the domestic offices of the Deputy Assistant Secretary and to all of the foreign posts under his direction. The actual planned change between fiscal years 1980 and 1981 in Developing Nations (as presented in the amended FY 1981 budget request) is $774,000. $700,000 of this amount is specifically for the salary equalization program; the remaining $74,000 is the net increase reflecting changes due to inflation and non-recurring costs. Less than half of this latter amount is specifically for the foreign posts, and represents an increase of slightly less than 4 percent between the two fiscal years.

Question: The cost of support services provided by other government and quasi-governmental organizations has increased by $232,000. What is the breakdown of the total cost of these services? How much did each increase?

Answer: The category "support services" comprises major payments to other government agencies for extensive assistant they provide to the International Affairs appropriation. In addition, miscellaneous types of inflationary increases (e.g., supplies) are carried in this category.

The two major increases are for overseas support services provided by the State Department and for computer support provided by the various Federal Reserve Banks.

The increase requested for payments to the State Department amounts to 8.1 percent over anticipated FY 1980 costs. The costs are based on the costs experienced by the State Department in operating programs overseas. Our costs climbed 33 percent in FY 1979 and are expected to climb an additional 18 percent in FY 1980. The situation has been improving, and this request for an increase of 8.1 percent reflects our confidence that it will continue to improve in FY 1981.

The bulk of all computer support provided to the programs funded by the International Affairs appropriation comes from the Federal Reserve Banks. Additional services are provided by the Treasury Department's Office of Computer Science (on a reimbursable basis) and other agencies. Total obligations for computer support have risen appreciably in the past few years, although total obligations include substantial modifications in the type and quantity of support in addition to inflationary cost increases. The increase requested for FY 1981 is approximately 4.8 percent above anticipated FY 1980 levels, with no expansion of computer support planned.

An additional $13,000 is requested for FY 1981 for purchase of supplies. This represents an inflationary increase of approximately 7.5 percent over the estimated requirement for FY 1980.

Specific costs are shown on the following table.

State Department support services:

FY 1980 requirement	$1,487,000
FY 1981 increase @ 8.1 percent	121,000

Data processing services:

FY 1980 requirement	2,044,000
FY 1981 increase @ 4.8 percent . . .	98,000

Supplies:

FY 1980 requirement	174,000
FY 1981 increase @ 7.5 percent	13,000
Total increase for support services services	$ 232,000

RESOURCE LEVELS

Question: Authorized positions have decreased from 553 in fiscal year 1977 to 460 in fiscal year 1980. Please describe the function transfers that were made to contribute to this reduction of resources for the International Affairs area.

Answer: The largest part of the reduction in resources came from the complete reorganization of functions that took place with this administration. Positions had increased from 376 to 553 between fiscal years 1970 and 1977, largely reflecting expanding work responsibilities brought on by the energy crisis and far-reaching changes in the U.S. role in the international financial arena. Many of these changes brought about rapid incremental changes in the existing organizational structure. When the current administration took office, efforts were undertaken to restructure the organizational framework within which Treasury conducted its international activities with the purpose of both improving responsiveness and increasing efficiency. This reorganization, which was implemented over a three year period, permitted the merging of similar functions and the de-emphasis of other functions -- such as energy financing -- which were better suited to be undertaken by other agencies.

The reductions that took place during this three year period were largely eliminations of vacant, superfluous positions that followed the reorganization rather than the transfer of resources to other agencies. Resources transfers have occurred, however, with the movement of the Foreign Assets Control functions to the Salaries and Expenses appropriation of the Office of the Secretary

(1976-77) and the transfer of five positions involved in international trade activities to the Office of the U.S. Trade Representative (1980).

OVERHEAD

Question: Administration and Administrative programs represent approximately 20% of the totals for International Affairs. Does the Department regard this as a somewhat high allocation for overhead support?

Answer: The FY 1981 International Affairs budget identified $4,648,000 in administrative costs. These costs were divided and placed with the direct program costs of the appropriations' two activities. When extracted from the budget document and compared to the total appropriation, it appears that the International Affairs appropriation has administrative overhead costs equivalent to 19.6 percent of the appropriation.

Approaching the cost of overhead in this manner is somewhat misleading for several reasons. For example, certain costs which are included within the line-items for administrative support are in fact office-wide support functions which are clearly integral parts of the direct program costs. Telecommunications costs, space rental, postage charges, and similar costs are budgeted and expended centrally because the time and effort that would have to be consumed in attributing such charges to each individual office simply does not result in any usable benefits. Whenever we receive a single bill for services (e.g., commercial telephone bills, GSA space rental charges, etc.) we budget centrally for that service. When such costs are extracted from the administrative overhead, there is a sharp change in the ratio of administrative to direct program costs. The true overhead costs are in the areas of budget, accounting, payroll, personnel, library services, procurement and other operational support. These items represent approximately 6.0% to 8.0% of the appropriation.

BUREAU OF THE MINT

STATEMENT OF STELLA B. HACKEL, DIRECTOR, BUREAU OF THE MINT

PREPARED STATEMENT

Senator CHILES. The committee will now receive testimony from the Bureau of the Mint regarding the fiscal year 1981 budget request and the pay supplemental request. We are pleased to have Ms. Stella B. Hackel, Director of the Mint, to present testimony. We will put your statement in full in the record and you may summarize it for us.

[The statement follows:]

Statement of Stella B. Hackel

Mr. Chairman and Members of the Committee, I am pleased to be here today to present the fiscal year 1981 appropriation request of the Bureau of the Mint.

We are requesting an appropriation of $60.956 million for Salaries and Expenses for the year, an increase of $1.599 million from the total of $59.357 million which is the proposed authorized level for the current fiscal year. The appropriation request reflects a decrease of 12 permanent positions as compared to fiscal year 1980. The authorized level for FY 1980 includes the pay increase supplemental of $310 thousand for classified pay increases in addition to the $59.047 million previously appropriated. The requested amounts reflect the administration's March 31, 1980, adjustments to the budget.

While our 1981 appropriation request is $60.956 million, revenues resulting from operations of the Bureau of the Mint are estimated to be about $451 million including seigniorage and miscellaneous revenues.

COIN PRODUCTION

The Mint has four (4) field offices engaged in the coin manufacturing process. They are: the Philadelphia and Denver Mints, the San Francisco Assay Office, and the West Point Bullion Depository. A varying range of coin related activities are conducted at each field office. The Philadelphia Mint manufactures all dies, coin bags, fabricates coinage strip, produces coins of all denominations from purchased and in-house strip and produces Mint List Medals. The Denver Mint produces coins of all denominations from purchased strip; the San Francisco Assay Office produces one-cent and one-dollar coins from purchased strip, manufactures and packages all proof coin sets, and packages

UNCIRCULATED COIN SETS. WEST POINT STRIKES ONE-CENT COINS FROM BLANKS FURNISHED BY THE PHILADELPHIA MINT OR PURCHASED COMMERCIALLY AND WILL PRODUCE AND PACKAGE THE 1/2 OUNCE AND 1 OUNCE GOLD MEDALLIONS FROM PURCHASED BLANKS.

FOR FISCAL YEAR 1981, WE EXPECT TO PRODUCE 15.0 BILLION COINS AT THE ABOVE FOUR (4) FACILITIES. OF THIS QUANTITY, 11.28 BILLION (OR 75%) ARE ONE-CENT COINS. NO FUNDS ARE BUDGETED FOR THE NEW ANTHONY DOLLARS. HOWEVER, IF PAYOUTS INCREASE FOR THE DOLLAR COIN, WE WILL NEED ADDITIONAL FUNDING.

THE 163.4 MILLION POUNDS OF COINAGE STRIP NEEDED FOR PRODUCTION OF THE 15.0 BILLION COINS WILL BE PROVIDED FROM BOTH IN-HOUSE AND COMMERCIAL SOURCES. THE PHILADELPHIA MINT HOUSES OUR ONLY STRIP FABRICATION PLANT AND WILL MANUFACTURE 35.9 MILLION POUNDS, OR 47% OF THE TOTAL 75.6 MILLION POUNDS OF STRIP REQUIRED AT THAT FACILITY DURING FY 1981.

IT IS TO BE NOTED THAT FISCAL YEAR 1979 COSTS ON IN-HOUSE STRIP COMPARE FAVORABLY WITH THE PRICE WE CURRENTLY PAY FOR PURCHASED STRIP. IN-HOUSE VERSUS PURCHASED STRIP COSTS ARE: CLAD, 35.0 VS. 43.1 CENTS; 5-CENT, 21.4 VS. 28.2 CENTS; AND 1-CENT STRIP, 16.8 VS. 15.5 CENTS PER POUND.

COIN REQUIREMENTS

THE PRIMARY RESPONSIBILITY OF THE MINT IS TO PROVIDE THE NATION WITH AN ADEQUATE SUPPLY OF COINS. OUR EFFECTIVENESS AND EFFICIENCY IN FULFILLING THIS FUNCTION SHOWS SIGNIFICANT IMPROVEMENTS. THE COMPUTERIZED MODELS IMPLEMENTED IN 1979 HAVE BEEN EXPANDED. THIS PROGRAM DESIGNED TO IMPROVE COIN DEMAND FORECASTING, PRODUCTION PLANNING, AND INVENTORY CONTROLS IS PROVING EFFECTIVE.

A TERMINAL PROVIDING ACCESS TO ECONOMIC INDICATORS NOW PROCESSES STATISTICAL DATA WITH ACCURACY AND SPEED. THIS ENHANCES OUR CAPABILITY TO BETTER ANALYZE THE RELATIONSHIP OF COIN DEMAND WITH ECONOMIC VARIABLES ON A TIMELY BASIS.

These efforts are designed to provide more objective and reliable forecasts.

An effective coin distribution program requires coordination between the Mint, the Federal Reserve Board, and each of the 12 Federal Reserve Banks and 25 branches. Significant improvements have been made in that area. Close cooperation with the Federal Reserve Board has resulted in a decrease in time required to collect monthly data reported by each of the Federal Reserve Banks. Monthly bank data is now collected in 10 days compared to 30 days.

During Fiscal Year 1979, the Mint produced 13.6 billion coins and shipped 14.3 billion to the Federal Reserve Banks. Mint inventories, therefore, dropped from 3.2 billion to 2.5 billion. The Federal Reserve Banks had a net payout of 13.8 billion as their inventories increased from 2.7 billion to 3.2 billion. Combined Mint/FRB inventories dropped from 5.9 to 5.7 billion.

During fiscal year 1980, we project production at 15.2 billion coins and demand of 15.2 billion coins. The combined Mint/FRB inventories, therefore, are expected to remain at 5.7 billion coins. However, in FY 1981, 15.0 billion coins is the budgeted production which will result in a reduction of one billion coins in inventories.

DEPOSIT ACTIVITY

The Deposit Activity includes the cost of preparing and loading coins for shipment from the Mint; the exchange of silver and gold bullion; and shipping, storing and verifying bullion and coins. The major element of cost in this activity involves the storage and subsequent release of new coins to the Federal Reserve Banks.

During the past year, nine (9) additional sites were added to the direct shipment program. Currently, therefore, THE PROGRAM INCLUDES 17 SITES. A TOTAL OF 305 MOVEMENTS WERE MADE TO THESE SITES WITH COMBINED MINT/FRB SAVINGS CALCULATED TO APPROACH $200 THOUSAND IN TRANSPORTATION AND LABOR COSTS. IN ADDITION, ESTIMATES INDICATE THAT ABOUT 15 TO 16 THOUSAND GALLONS OF FUEL WERE SAVED.

STUDIES ON THE PURCHASE VERSUS IN-HOUSE MANUFACTURE OF COIN BAGS HAVE BEEN COMPLETED. THE RESULTS HAVE INDICATED PURCHASED COIN BAGS ARE SIGNIFICANTLY LOWER IN COST AND DURING FY 1979 APPROXIMATELY 1 MILLION COIN BAGS WERE PURCHASED. TO DATE IN FY 1980, WE HAVE PURCHASED APPROXIMATELY 700 THOUSAND COIN BAGS. IMPLEMENTATION OF BULK SHIPMENTS OF ONE-CENT COINS IN RECENTLY PURCHASED FIBERGLASS-REINFORCED POLYESTER CONTAINERS WILL COMMENCE DURING FY 1980. EACH BULK CONTAINER ELIMINATES THE NEED FOR SIXTY COIN BAGS. QUANTITIES WILL BE SHIPPED BY WEIGHT AND COUNT USING NEW COIN-COUNTING ELECTRONIC SCALES.

PROTECTION

THE UNITED STATES MINT SECURITY FORCE PROTECTS ALL THE GOLD AND SILVER BULLION, MONETARY ASSETS OF COINAGE AND METALS, AND EMPLOYEES AT THE SEVEN MINT FIELD OFFICES. AS OF SEPTEMBER 30, 1979, THE MINT INVENTORY WAS 254.5 MILLION FINE TROY OUNCES OF GOLD AND 39.1 MILLION FINE TROY OUNCES OF SILVER. THE TRANSITION OF THE SECURITY FORCE FROM GUARDS TO POLICE OFFICERS HAS RESULTED IN A BETTER TRAINED AND PROFESSIONAL PROTECTION FORCE. EIGHTY-THREE PERCENT OF THE SECURITY PERSONNEL HAVE COMPLETED BASIC POLICE TRAINING AT THE FEDERAL LAW ENFORCEMENT TRAINING CENTER AT GLYNCO, GEORGIA, AND ALL NEW OFFICERS WILL BE TRAINED AT THE FACILITY. WE NOW HAVE A SECURITY FORCE WITH TRAINING EQUIVALENT TO THAT PROVIDED OTHER FEDERAL LAW ENFORCEMENT AGENCIES.

THE UNITED STATES SECRET SERVICE CONDUCTED SECURITY SURVEYS OF THE MAJOR UNITED STATES MINT FACILITIES AND MADE RECOMMENDATIONS TO IMPROVE THE PROTECTION PROVIDED OUR

RESOURCES. THE UNITED STATES SECRET SERVICE SPECIAL AGENTS CONDUCTED A THOROUGH EVALUATION WHICH RESULTED IN A NUMBER OF RECOMMENDATIONS. OVER ONE-HALF OF THE FEASIBLE RECOMMENDATIONS HAVE BEEN IMPLEMENTED AND WE HAVE DEVELOPED A PROGRAM TO IMPLEMENT ALL THE REMAINING FEASIBLE RECOMMENDATIONS. TWO MAJOR PROBLEM AREAS IDENTIFIED WERE THE NEED TO IMPROVE THE TECHNICAL SYSTEMS USED TO PROTECT OUR ASSETS AND THE NEED TO IMPROVE OUR EMPLOYEE ENTRY AND EXIT CONTROLS. WE HAVE BEGUN A PROGRAM TO IMPROVE THESE SYSTEMS AND PROCEDURES.

REFINING

FUNDS REQUESTED FOR REFINING OF BULLION IN FY 1981 ARE CONSIDERABLY LOWER THAN IN FY 1979, WHILE THE OUTPUT OF REFINED GOLD IS SUBSTANTIALLY HIGHER. BECAUSE OF THE SIGNIFICANT IMPROVEMENT IN REFINERY PRODUCTIVITY, REFINING OPERATIONS AT THE NEW YORK ASSAY OFFICE HAVE BEEN CONTINUED.

TREASURY DEPARTMENT, BUREAU OF THE MINT, AND NEW YORK ASSAY OFFICE MANAGEMENT EMBARKED UPON A CONTINUING PROGRAM OF IMPROVED ACCOUNTABILITY, SECURITY, AND MATERIAL CONTROL. WITH EMPLOYEE AND UNION COOPERATION, SIGNIFICANTLY HIGHER PRODUCTION HAS BEEN ACHIEVED WITH FEWER REFINERY WORKERS.

FY 1978 PRODUCTION WAS 2.02 MILLION OUNCES OF GOLD; FY 1979 GOLD PRODUCTION WAS 2.8 MILLION OUNCES; FY 1980 AND FY 1981 PRODUCTION WILL BE MORE THAN THREE MILLION OUNCES OF GOLD.

REFINING POSITIONS DECREASED FROM 103 IN FY 1978 TO OUR REQUEST FOR 90 IN FY 1981. IN ADDITION, OVERALL EMPLOYMENT INCLUDING ADMINISTRATIVE AND OTHER NON-REFINING ACTIVITIES AT THE NEW YORK ASSAY OFFICE HAS DECREASED FROM 209 TO 167.

EQUIPMENT ACQUISITION

FUNDS IN THE AMOUNT OF $2.4 MILLION ARE REQUESTED FOR PRODUCTION EQUIPMENT PLUS SYSTEMS NECESSARY TO IMPROVE THE AIR QUALITY IN THE PHILADELPHIA MINT MELTING AND STRIP MANU-

FACTURING PROCESS. IN ADDITION, WHERE POSSIBLE, BUILDING HEATING SYSTEMS WILL BE MODIFIED TO USE COAL IN PLACE OF NATURAL GAS AND FUEL OIL. EQUIPMENT REQUIRING LONG-LEAD TIME THAT IS TO BECOME OPERATIONAL BY FY 1982 MUST BE CONTRACTED A YEAR OR MORE IN ADVANCE.

GOLD MEDALLIONS

THE AMERICAN ARTS GOLD MEDALLION ACT WAS ENACTED ON NOVEMBER 10, 1978. THE MANUFACTURE AND DISTRIBUTION OF ONE OUNCE AND HALF-OUNCE GOLD MEDALLIONS WILL PROVIDE THE GENERAL PUBLIC WITH AN OPPORTUNITY TO ACQUIRE GOLD MEDALLIONS WHICH HONOR OUTSTANDING INDIVIDUALS IN THE AMERICAN ARTS.

CONTRACTS FOR BLANK FABRICATION OF TREASURY GOLD HAVE BEEN AWARDED AND MEDALLION PRODUCTION IS SCHEDULED TO BEGIN IN MARCH 1980. THE WEST POINT BULLION DEPOSITORY WILL MANUFACTURE, PACKAGE AND MAIL THE MEDALLIONS.

PLANS CALL FOR ORDERS TO BE ACCEPTED IN JUNE 1980. ORDER PROCESSING AND CUSTOMER RELATIONS WILL BE HANDLED BY THE SAN FRANCISCO OLD MINT.

FUNDS REQUESTED FOR PRODUCTION, MARKETING AND DISTRIBUTION OF GOLD MEDALLIONS ARE $1.053 MILLION HIGHER THAN THOSE REQUESTED FOR FY 1980. WE ARE HOPEFUL THAT THIS INCREASE WILL BE SUFFICIENT TO COVER INCREASES IN BLANK FABRICATION AND OTHER COSTS WHICH VARY WITH THE MARKET PRICE OF GOLD.

UNTIL WE ACTUALLY RECEIVE THE ORDERS, A NUMBER OF COSTS RELATED TO ORDER QUANTITIES, ORDER RATES, AND POSTAGE COSTS WERE NECESSARILY ESTIMATES DERIVED WITHOUT HISTORIC BASIS.

IT SHOULD ALSO BE NOTED THAT OUR $208 MILLION ESTIMATE OF THE GENERAL FUND RECEIPTS FROM THIS PROGRAM WAS BASED UPON A GOLD PRICE OF $250 PER OUNCE. EACH ADDITIONAL DOLLAR INCREASE IN THE GOLD PRICE WILL INCREASE GENERAL FUND RECEIPTS BY $1 MILLION.

NUMISMATIC AND OTHER REIMBURSABLE OPERATIONS

Our several coinage and medal programs for FY 1981 will include Proof Coin Sets, Uncirculated Coin Sets and List and Congressionally authorized medals. Although we are limiting our expenditures in maintaining personnel ceilings at a minimum consistent with the policies of the administration, we have been able to improve our programs and better satisfy our customers through earlier shipment of products and more expeditious response to inquiries.

Renovations and improvements to the public area space at the Denver Mint which for many years had been inadequate for the number of visitors touring that facility were made in FY 1979 and FY 1980. We plan to continue to maintain and improve the public areas at all Mint facilities utilizing in-house workforce to the extent feasible.

The manufacture of coins for foreign governments is also a part of the Mint's reimbursable program. Due to domestic coinage production workloads, the manufacture of coins for foreign governments has diminished and we project that it will continue at a low rate in FY 1981. We undertake to manufacture foreign coinage only when there is excess capacity. This enables us to better utilize our personnel and equipment and to reduce overhead costs.

There has been an increase in the number of congressional approved National Medal Bills which has increased our medal Production Workload. Costs for reimbursable work are recovere from the sales proceeds of our various products.

AUTOMATIC DATA PROCESSING

The Bureau of the Mint Data Center is located in the San Francisco Old Mint. Processing is accomplished on a large-scale third generation computer which provides ADP support to (1) all organizations within the Bureau of the

MINT; (2) AGENCIES WHICH ARE SUPPORTED ON THE DEPARTMENT OF THE TREASURY PAYROLL/PERSONNEL INFORMATION SYSTEM AS APPROVED BY THE OFFICE OF THE SECRETARY OF TREASURY; AND (3) OTHER GOVERNMENT AGENCIES AS EXCESS COMPUTER TIME IS AVAILABLE AND IS AUTHORIZED BY THE DIRECTOR OF THE MINT.

THE NUMISMATIC COIN OPERATION SYSTEM, WHICH SERVICES THE MINT'S COIN SET AND MEDAL SALES PROGRAM, AND THE TREASURY PAYROLL/PERSONNEL INFORMATION SYSTEM (TPPIS) (BOTH OF WHICH ARE REIMBURSABLE PROGRAMS), ARE THE TWO MAJOR APPLICATIONS BEING PROCESSED. TPPIS IS OPERATED UNDER THE DIRECTION OF THE OFFICE OF THE SECRETARY AND PROVIDES STANDARDIZED PAYROLL AND PERSONNEL SERVICE FOR ALL TREASURY EMPLOYEES (EXCEPT THE INTERNAL REVENUE SERVICE) AND EMPLOYEES OF THE EXECUTIVE OFFICE OF THE PRESIDENT (12 AGENCIES INCLUDING THE WHITE HOUSE STAFF AND THE OFFICE OF MANAGEMENT AND BUDGET), THE NATIONAL GALLERY OF ART, THE FEDERAL TRADE COMMISSION, AND THE FEDERAL EMERGENCY MANAGEMENT AGENCY. THIS SYSTEM SERVICES APPROXIMATELY 50,000 FEDERAL EMPLOYEES.

THE BUREAU OF THE MINT HAS ADDITIONAL OPERATIONAL COMPUTER SYSTEMS WHICH PROVIDE INFORMATION TO VARIOUS LEVELS OF THE MINT MANAGEMENT. THESE INCLUDE SYSTEMS WHICH TRACK THE LOCATION OF THE PALLETS UPON WHICH COINS ARE SHIPPED, PROCESS THE TREASURY DEPARTMENT GOLD SALES BY THE GSA, PROVIDE OPERATING DATA ON THE MAJOR PIECES OF COIN PRODUCTION EQUIPMENT, PROVIDE COINAGE DIE INFORMATION, PROCESS THE FIRST MODULE (GENERAL LEDGER/APPROPRIATION ACCOUNTING) OF THE MINT'S FINANCIAL MANAGEMENT INFORMATION SYSTEM, AND PROCESS LABOR DISTRIBUTION INFORMATION. IN ADDITION, THE NEED FOR THE FOLLOWING CAPABILITIES HAS BEEN IDENTIFIED AND IS NOW IN THE DEVELOPMENTAL STAGE: GOLD MEDALLION ORDER PROCESSING PROGRAM; COINAGE STRIP INVENTORY CONTROL SYSTEM; ADDITIONAL MODULES TO THE FINANCIAL MANAGEMENT INFORMATION SYSTEM; AND

Preventive Maintenance System. We also provide data processing services to 25 other Federal Departments and Agencies through telecommunications terminals.

Computer terminals are operational at all Bureau of the Mint locations with the exception of Fort Knox. These computer terminals were acquired to enable the Bureau of the Mint to join the Department of the Treasury's Payroll/Personnel network. They are also used to process data relative to in-house Mint applications.

To insure the accurate and timely processing of all present and proposed Mint computer applications, as well as provide prompt service to our outside users, we have acquired additional surplus Government-owned memory from the U.S. Customs Service.

SAFETY AND HEALTH

The objective of the Mint's Safety and Health Program is to provide a safe and healthful working environment for all our employees. Our safety and health specialists at each field office have primary responsibility for accident prevention, and they in turn receive professional guidance from our Safety Office here in Washington.

We have established an industrial hygiene program at each major facility including in-house capability to monitor and evaluate air quality throughout the work area. Some deficiencies have been corrected and engineering studies are in progress, or have been proposed, to develop methods to reduce hazardous environmental conditions.

In addition, other studies are currently being conducted to minimize hazardous working conditions. Human Factors Engineering studies are being conducted to alleviate physiological problems. Noise abatement projects are continuing at each production facility. Ventilation modifications are

BEING INSTALLED WHERE NEEDED. VALUE ENGINEERING STUDIES ARE CONDUCTED TO INVESTIGATE ALTERNATIVE PRODUCTION METHODS, AND THE SAFETY MANAGER HAS INPUT TO THE MINT IMPROVEMENT STUDIES.

OUR INCREASED EMPHASIS ON OCCUPATIONAL SAFETY AND HEALTH IS SHOWING RESULTS. FOR THE LAST TWO CALENDAR YEARS, THE NUMBER OF DISABLING INJURIES HAS BEEN STEADILY DECLINING. OUR DISABLING INJURY FREQUENCY RATE HAS DROPPED 18% IN 1979 AND HAS DROPPED 30% OVER THE LAST TWO YEARS.

WHILE WE HAVE REALIZED SIGNIFICANT IMPROVEMENTS, THE NUMBER OF DISABLING INJURIES AND ILLNESSES IS STILL TOO HIGH. WE WILL CONTINUE OUR EFFORT IN THE FUTURE TO ELIMINATE UNSAFE AND UNHEALTHFUL WORKING CONDITIONS THROUGHOUT THE MINT FACILITIES.

INTERNAL AUDIT

INTERNAL AUDIT IS ORGANIZED TO PROVIDE CONCURRENT BROAD BASED AUDITS AND EVALUATIONS OF COMMON AREAS AT ALL FACILITIES. THE AUDITS ARE CONDUCTED IN ACCORDANCE WITH GENERALLY ACCEPTED AUDITING STANDARDS PROMULGATED BY THE U.S. GENERAL ACCOUNTING OFFICE. THE AUDITS ARE DESIGNED TO PROVIDE A DETERMINATION OF THE RELATIVE EFFECTIVENESS OF MANAGEMENT, EFFICIENCY AND ECONOMY IN THE USE OF RESOURCES, FINANCIAL AND FUNCTIONAL OPERATIONS AT EACH FACILITY AND TO ENSURE ADHERENCE TO INTERNAL SECURITY AND FISCAL RESPONSIBILITY MEASURES.

INTERNAL AUDIT IS ALSO RESPONSIBLE FOR ASSISTING IN THE DEVELOPMENT OF POLICIES, PRACTICES AND PROCEDURES THROUGHOUT THE MINT; EVALUATING THE EFFECTIVENESS OF PROPOSED CHANGES; AND, PERFORMING FOLLOW-UP AUDITS TO ENSURE THAT IMPLEMENTATION HAS RESULTED IN MORE EFFICIENT AND ECONOMICAL OPERATIONS.

DURING THE PAST YEAR, NEW AUDIT FOLLOW-UP PROCEDURES WERE IMPLEMENTED TO ENSURE TIMELY PERIODIC TRACKING OF AUDIT RECOMMENDATIONS TO DETERMINE THAT INTENDED IMPROVEMENTS ARE ACHIEVED. THE PROCEDURES ALSO PROVIDE FOR A DETERMINATION

OF THE EFFECTIVENESS OF SUCH ACTIONS AND THE REPORTING OF PROBLEMS TO THE DIRECTOR.

FISCAL YEAR 1979 AUDITS INCLUDED THE MELTING AND REFINING ACTIVITIES AT THE NEW YORK ASSAY OFFICE; NUMISMATIC SALES FACILITIES IN WASHINGTON, DENVER, PHILADELPHIA AND SAN FRANCISCO; PROCUREMENT PRACTICES AT THE PHILADELPHIA MINT; AND, CONTROLS OVER TRAVEL EXPENDITURES AND CASH ASSETS AT THE DENVER MINT. CONCURRENT LATERAL AUDITS OF APPROPRIATION ACCOUNTING AND PAYROLL ACTIVITIES AT ALL FIELD OFFICES WERE ALSO CONDUCTED DURING THE YEAR. AUDIT WORK CONTRIBUTED TO THE STRENGTHENING OF INTERNAL CONTROLS AND THE ACCOUNTING AND REPORTING SYSTEMS; IMPROVED REFINERY PRODUCTIVITY, ACCOUNTABILITY AND REPORTING OF PRECIOUS METALS; MORE EFFECTIVE MANAGEMENT OF NUMISMATIC SALES FACILITIES; AND, IMPROVED SAFETY AWARENESS.

AFTER INTENSIVE MANAGEMENT AND ORGANIZATION CHANGES DURING 1979, A COST/BENEFIT ANALYSIS WAS MADE OF PRECIOUS METALS REFINING AT THE NEW YORK ASSAY OFFICE. THE ANALYSIS FOUND THAT IN-HOUSE REFINING WAS MORE ECONOMICAL THAN CONTRACTING OUT. AN AUDIT OF THIS ANALYSIS CONCLUDED THAT THE COST ESTIMATE FOR IN-HOUSE OPERATIONS WAS CURRENT, COMPLETE AND ACCURATE, AND THAT THE PROCEDURES FOLLOWED WERE IN COMPLIANCE WITH REQUIREMENTS OF THE OFFICE OF MANAGEMENT AND BUDGET.

TIMELY ACTION ON MATTERS BROUGHT TO OUR ATTENTION BY THE AUDITORS HAS ENABLED US TO ACCOMPLISH OUR MISSION MORE EFFECTIVELY AND ECONOMICALLY. IN THIS REGARD, THE INTERNAL AUDIT FUNCTION IS A VITAL AND ACTIVE MANAGEMENT AID TO THE DIRECTOR OF THE MINT.

CONTINUING AUDITS OF GOLD

A PROGRAM FOR THE CONTINUING AUDIT OF UNITED STATES-OWNED GOLD COMMENCED IN 1974 WHEN THE TREASURY DEPARTMENT, WITH THE PARTICIPATION OF THE UNITED STATES GENERAL ACCOUNTING OFFICE, CONDUCTED AN AUDIT AT THE FORT KNOX BULLION DEPOSITORY.

Continuing audits are performed at each Mint Depository with the objective of auditing about ten percent annually until the entire gold stock has been verified.

Through the end of fiscal year 1979 over sixty-two percent of United States-owned gold bullion in permanent storage at Mint Depositories had been audited and found to agree with the records. This represented 166.4 million of the 264.8 million fine troy ounces of gold bullion owned by the United States as of September 30, 1979.

These audits have been performed jointly by the Bureau of the Mint and the Bureau of Government Financial Operations with representatives of the United States General Accounting Office generally present as observers.

EQUAL EMPLOYMENT OPPORTUNITY

Currently, the Mint workforce composition of minorities and women is: 36% minority males, 13% minority women and 6% non-minority women. However, these statistics do not reflect minority and women representation in all occupations and grade levels. Under the new guidelines issued by the Office of Personnel Management and the Equal Employment Opportunity Commission, the Mint has prepared Federal Equal Opportunity Recruitment and Affirmative Action Plans which will improve the under-representation rate of minority men, minority women and non-minority women in specific occupations and grades. Resources have been allocated to implement special emphasis programs to improve the employment and career development profiles for minorities and women. In FY 1981, the Mint will develop a multi-year affirmative action plan as mandated by the Equal Employment Opportunity Commission.

A Bureau level Hispanic Employment Program Manager was appointed to coordinate the efforts of Hispanic Managers at the Installation level and to advise managers and supervisors

AT ALL LEVELS OF THE BARRIERS THAT HAVE IMPEDED THE EMPLOYMENT OPPORTUNITIES OF HISPANICS.

WE ARE IN THE PROCESS OF IMPLEMENTING AN EEO AWARD PROGRAM BUREAU-WIDE TO RECOGNIZE THE OUTSTANDING CONTRIBUTIONS MADE BY MINT EMPLOYEES IN THE AREA OF AFFIRMATIVE ACTION, COUNSELING AND SPECIAL EMPHASIS PROGRAMS. THIS EEO AWARD PROGRAM WILL BRING ATTENTION TO EXCELLENCE AND SUPERIOR PERFORMANCE WHICH WILL PUBLICIZE OUR EEO GOALS AND OBJECTIVES TO MANAGEMENT AND EMPLOYEES. A TRAINING PROGRAM DESIGNED FOR MANAGERS, SUPERVISORS AND EEO OFFICIALS WILL BE DESIGNED TO INSURE UNDERSTANDING AND IMPLEMENTATION OF THE NEW CHANGES IN THE EEO PROGRAM RESULTING FROM THE CIVIL SERVICE REFORM ACT AND THE NEW UNIFORM GUIDELINES ON EMPLOYEE SELECTION PROCEDURES.

PERSONNEL

THE STEADY DECLINE IN FULL TIME POSITIONS AUTHORIZED THE BUREAU CONTINUED WITH A FY 1979 CEILING OF 2,366 AS CONTRASTED WITH FY 1978 CEILING OF 2,426. THIS REPRESENTS A DROP OF OVER 446 FULL TIME POSITIONS SINCE FY 1974. THE COMPREHENSIVE AUDIT OF THE CLASSIFICATION OF ALL GS POSITIONS WAS FINALIZED DURING THE FISCAL YEAR. EMPHASIS ON SUPERVISORY AND MANAGERIAL TRAINING CONTINUED DURING THE FISCAL YEAR.

THIS COMPLETES MY PREPARED REMARKS AND I WILL BE PLEASED TO ANSWER ANY QUESTIONS YOU MAY HAVE.

INTRODUCTION OF ASSOCIATES

Ms. HACKEL. I would like to introduce my other witnesses today, Dr. Alan Goldman, who is our Deputy Director and Assistant Director, Mr. Galen Dawson, who is our Assistant Director for Production, Mr. Joseph Wagner, who is our Acting Assistant Director of the Budget and Finance, and Mr. Arthur Kallen from the Budget Office of the Treasury Department.

Senator CHILES. We see Mr. Kallen a lot.

SUMMARY OF STATEMENT

Ms. HACKEL. I am delighted to be here, Mr. Chairman, to present the appropriation request for the Bureau of the Mint. We are requesting an appropriation of $61 million this year, which is $1.6 million more than the proposed authorized level for last year. That proposed authorized level included $310,000 because of pay increases in addition to the $59 million that had been appropriated.

We are going to receive revenues resulting from the operations of the Mint of close to one-half a billion dollars, most of it from seigniorage. The Mint has four coin production facilities and for coin production we are requesting $37.9 million, which is just very little over last year's production costs approved level in fiscal year 1980.

Our four production facilities are Philadelphia and Denver, which together produce 85 percent of all of our coinage, the San Francisco Assay Office, which makes $1 coins and 1 cent coins and, of course, we have nothing in the budget this year, fiscal year 1981 for the Anthony coin; and the West Point Bullion Depository which makes 1 cent coins. Philadelphia also produces strip for coinage and makes some coin bags.

The West Point facility this year will be producing the gold medallions for the gold medallion program. They will be stamping them, packaging them, and mailing them from West Point.

For fiscal year 1981 we plan to produce 15 billion coins and of that quantity 11.3 billion will be 1 cent coins. I am using round figures. I hope you do not object.

As I stated earlier, there are no funds budgeted for the Anthony dollar coin. If there should be a substantial increase in demand, we may need additional funding. The Mint needs 163 million pounds of coinage strip to produce the 15 billion coins and the Philadelphia Mint will produce 36 million pounds or 47 percent of what is necessary for usage at that facility.

Our fiscal year 1979 costs do compare favorably with the price we currently pay for purchased strip.

COIN REQUIREMENTS

In reference to coin requirements, the primary responsibility of the Mint of course is to provide the Nation with an adequacy of coins and the computerized models that we implemented in 1979 improved coin demand forecasting, inventory control, and production planning. An effective coin distribution system requires the complete cooperation of the Mint and the Federal Reserve System which we are very pleased to report is in place. The Federal Reserve System has been very cooperative.

During fiscal year 1979 the Mint produced 13.6 billion coins and the Federal Reserve had a net payout of 13.8 billion, so that combined Mint and Federal Reserve inventory has dropped from 5.9 to 5.7 billion at the end of that fiscal year.

During fiscal year 1980 the projected production is 15.2 billion and demand 15.2 billion, so that the inventory should remain the same. However, if the increased demand for the coins that we have been experiencing since the start of this calendar year continues to occur, we may be paying out more than 15.2 billion coins.

In fiscal year 1981 we are budgeted assuming it is approved by the Congress for 15 billion coins and we expect to be paying out 16 billion coins, so that our inventory at the end of that fiscal year probably will be down to 4.7 billion.

DEPOSIT ACTIVITY

The major element of cost in the deposit activity for which we are requesting $2.7 million which is slightly over last year, last year it was $2.6 million, the major element of cost is the storage and the subsequent release of the coins to the Federal Reserve System. During the past year we added nine additional sites to the direct shipment and have saved over $200,000 in transportation costs, in addition to saving fuel.

On the coin bags, we formerly produced all coin bags, but the 1976 study found it was much cheaper to buy coin bags than it was for us to produce them and we are implementing that program and as attrition occurs in the Philadelphia plant we will be buying coin bags exclusively.

PROTECTION

On protection, we are requesting $4.3 million this year and the U.S. Mint security force protects all of the gold and silver bullion of the U.S. Government, coin monetary assets, and employees. The Mint inventory as of the end of September was 254½ million troy ounces of gold. The remaining is held in the Federal Reserve Bank. Also we store 39 million troy ounces of silver.

The U.S. Secret Service conducted a thorough security survey of the New York Assay Office and we have implemented nearly all of the recommendations and the security is improved there. Thereafter we did a security check of all of our Mint coinage facilities and we are in the process of implementing all of the feasible recommendations to improve our security.

Much of the problem has been the need to improve exit procedures and equipment.

REFINING

On refining, we are requesting less than last year, somewhat less, $2.4 million while since the calendar year 1978 we increased production of the refined gold at the New York Assay Office about 60 percent. At the same time we decreased the employment about 20 percent. This was the result of some very significant management changes we made in the

New York Assay Office to improve security, to improve productivity, and to improve control of the materials while they were being processed in the refining process.

Senator CHILES. I will have to ask you to brief this a little bit more for us. Our time is running out.

EQUIPMENT

Ms. HACKEL. We are asking for equipment, $2.4 million, $1.4 million is for replacement equipment and the remainder is for improvements.

GOLD MEDALLIONS

On the gold medallion program handled at West Point, we will be accepting orders June 16 for the one-half ounce medallion and July 1 for the 1 ounce.

Senator CHILES. What are they going to sell for?

Ms. HACKEL. They will sell for whatever the market price is on the daily orders, plus production distribution costs which we expect will not exceed about 3 percent on the price of gold.

REIMBURSABLE PROGRAM

On the other reimbursable programs, we are not asking for appropriated funds.

AUTOMATIC DATA PROCESSING

Automatic data processing, our Mint data center is in San Francisco. The two primary applications are the NUCOS, numismatic coin operation and the TPPIS, which services 50,000 employees of the Federal Government for personnel and payroll information. Our usage has improved substantially in recent years. We now have a 65- to 75-percent usage during most periods of time and during the high process workload 100 percent.

SAFETY AND HEALTH

Our safety and health program has been very effective during the past 2 years. We have actually succeeded in decreasing the disabling injury frequency rate 30 percent during the past 2 years. In view of the fact there has been no change in the Federal law on compensation pay, we think that is a good achievement.

CONTINUING AUDITS OF GOLD

We have continued audits of gold so that at the end of fiscal year 1979, over 62 percent of the U.S. gold bullion stored in permanent storage in Mint depositories has been audited and found to be correct.

EQUAL EMPLOYMENT OPPORTUNITY

On equal employment opportunity, we are making substantial progress. Because we are a blue-collar operation there is a large percentage of our work force, minority and women. However, there is a definite under-representation in the higher level positions and we are attempting to correct that.

That concludes my statement.

COIN INVENTORIES

Senator CHILES. Thank you, madam. How many months supply of coins is represented by the inventory projection by the end of fiscal year 1981?

Mr. HACKEL. The inventory rate now is 6 weeks for 1 cent coins. If the demand continues as it is going on 1 cent coins, we will have a problem. In terms of the other coinage, it is between 9 to 12 months. But the 1 cent coins are going to be a problem. That represents 75 percent of our production, weighted about 60 percent.

Senator CHILES. For the last 5 years how many months supply of inventory has there been in each of those years?

Ms. HACKEL. We will give you those figures. It has been decreasing over the past several years.

[The information follows:]

COMBINED MINT FRB INVENTORIES CONVERTED TO SUPPLY IN WEEKS

	Inventory	Supply in weeks
September 30, 1975:		
Cents	2,072	14.6
Other	3,255	60.2
Total	5,327	27.2
September 30, 1976:		
Cents	3,266	19.4
Other	3,739	71.9
Total	7,005	31.8
September 30, 1977:		
Cents	2,936	15.4
Other	4,070	65.0
Total	7,006	27.6
September 30, 1978:		
Cents	2,532	13.0
Other	3,336	48.6
Total	5,868	22.2
September 30, 1979:		
Cents	2,907	11.3
Other	2,760	39.4
Total	5,667	17.4
Current April 30, 1980:		
Cents	1,310	5.1
Other	3,130	44.7
Total	4,440	13.6

PRODUCTION COSTS

Senator CHILES. It has been decreasing?

Ms. HACKEL. An ideal inventory would be about 8 billion coins, but we have not had that for several years.

Senator CHILES. What is the dollar cost associated with the producing of 1.3 billion inventoried coins by the end of fiscal year 1981?

Ms. HACKEL. It depends on the particular coinage. On the 1 cent coin, the coin costs nine-tenths of a cent. On the dollar coin, it costs 3 cents, on the 50 cent coin, the coin would cost 4 cents, on the quarter coin, 2 cents, on the 10 cent coins, 1 cent, and the nickel coin, 2 cents.

Senator CHILES. What is your current cost of producing pennies?

Ms. HACKEL. If we are using an average figure of our copper, some pay more and some less, but the average of our copper in storage is now about nine-tenths of a cent. Seven-tenths of a cent is probably closer to it.

Senator CHILES. When does it look like it will cost more than a penny to produce it?

Ms. HACKEL. The break-even production point is when the copper rises to $1.12 a pound. We just purchased some at about 93 cents, but earlier on we purchased some for about $1.19 but most of ours in storage was in the 90-cent range.

Senator CHILES. What is your plan, to propose a different metal composition?

ALTERNATIVE ALLOY

Ms. HACKEL. We are considering an alternative alloy and we have considered four alloys very seriously. The one that looks the most promising, because it looks exactly like the 1 cent coin that we presently have, and will strike just as well. A copper-zinc would achieve savings of over $50 million annually if we did proceed.

It appears that because the coin is copper-zinc, we would not need to get additional authorization from the Congress, but of course Congress would be consulted on the new alloy. But that is still in the consideration stage.

STATUS OF GOLD MEDALLION PROGRAM

Senator SCHMITT. What is the status of the gold medallion program?

Ms. HACKEL. The gold medallion program we have started to strike at West Point. We have been having some difficulty getting our blanks from our two suppliers. We have got at least 150,000 already for 1 ounce. We are concerned about the one-half ounce supplier because the blanks we assayed or tested were not adequate.

Senator SCHMITT. Every time we call I guess for the last 3 months we get the same answer, that we are in the process of striking the blanks.

Ms. HACKEL. We didn't start striking until within the last few weeks. That was the first time we had the supplies from the supplier. That has been our delay. When you have contractors and they delay, it is just a problem, you can't overcome it.

Senator SCHMITT. We will try to watch over it and we keep getting about the same answer from the congressional liaison, for the last several months.

Ms. HACKEL. We have started production of the 1 ounce.

Senator SCHMITT. You still have some problems?

Ms. HACKEL. We still have some problems with that supplier.

Senator SCHMITT. Is it problems in the artwork?

Ms. HACKEL. No; that is all set. We changed the design of the reverse of the 1 ounce but that didn't delay us at all. We had time to do that. The original one approved by the Fine Arts Commission was, frankly, it turned out to be dreadful.

Senator CHILES. Are these going to come out originally in a proof set?

Ms. HACKEL. They won't be proof struck. They will be very simply packaged, plastic packaged.

Senator CHILES. There won't be anything to signify this is a lot 1, first lot, or anything that will give it an enhanced value?

Ms. HACKEL. No; of course the artist is different from those of subsequent years. It will be a different American for the one-half ounce and 1 ounce. In subsequent years those artists will change. So it would be obviously a 1980 medallion because of the artist. That is mandated by the legislation.

Senator CHILES. So it changes every year?

Ms. HACKEL. Yes.

Senator CHILES. So other than the price of gold, it won't make any difference?

Ms. HACKEL. That is correct.

Senator CHILES. I might have a few more questions for the record.

Ms. HACKEL. Thank you.

SUSAN B. ANTHONY COIN

Senator SCHMITT. Your budget submission does not contain money for production of the Susan B. Anthony coin.

Ms. HACKEL. That is correct.

Senator SCHMITT. Would you explain that to me?

Ms. HACKEL. We produced $840 million of them. We have now distributed close to 300 million. So there is a combined inventory in the Mint and Federal Reserve of 540 million. Should there be substantial increased demand we might come back for more funding for the Susan B. Anthony coin. At this time it appears we have sufficient inventory.

Senator SCHMITT. Has the public accepted it as a collectors item but not as a useful item? Haven't they just sort of disappeared out there, the 300 million?

Ms. HACKEL. I think there are some that are in use. Since the Postal Service program, we did distribute 20 million more since the first of February, which is really much better than any experience we have had since last August——

Senator SCHMITT. I can honestly say, Mr. Chairman, that I think since the first couple of weeks I have never seen a Susan B. Anthony coin anywhere.

Senator CHILES. Most places will not give them to you or accept them.

Ms. HACKEL. It is the first change in size of coinage in 122 years.

Senator CHILES. The Postmaster General said they find that people will take one, if you are giving it to them for change, but if you try to give them four, they won't take four. In other words, if they had a $5 bill, they had $4.86. If you give them one, they will take that. But if you give them four, they say no, they don't want it.

Senator SCHMITT. I haven't had anybody try to give me one.

Ms. HACKEL. In an ideal coinage situation, you would produce two $2 notes and you wouldn't have to take four.

Senator SCHMITT. That is as phoney as a $2 bill. [Laughter.]

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

EXPANSION TO MINT REQUIRED TO MEET PRODUCTION REQUIREMENTS

Question: I understand that the $8.9 million request has been withdrawn as a part of the President's 1981 budget amendments. Is that correct?

Answer: The $8.9 million was withdrawn as a part of the Administration's March 31, 1980 adjustments to the FY 1981 budget.

Question: What is the current coin production capacity of Mint facilities (16 billion) and when will demand for coins exceed current production capacity (1981)?

Answer: Current coin production capacity of Mint facilities is stated to be 16.2 billion coins. Inventories at the end of FY 1980 for each denomination except for the dollar will be reduced below levels required for efficient operations. At these levels, we cannot produce the number of cents required to meet the current inflated demand which is averaging 65% over the prior year. If we divert our production capacity to the one cent coins, this would create a shortfall in the other denominations.

Although our capacity is 16.2 billion coins, we are only budgeted to produce 15.0 billion coins for FY 1981. Production at this level will not only compound the cent shortage, but will fall short of the 16.2 billion coin demand estimated for FY 1981. As a result, the shortage will spread to the other denominations.

Question: Couldn't production capacity be expanded by going to a 6-day workweek and by selective equipment additions? (yes)

Answer: Production capacity is increased by use of selective weekend work, and the Mint uses this alternative when necessary and as funds are available. Production capacity was only one of the planned benefits of the Mint Expansion and Improvement plan. To expand production capacity on a permanent basis by working a 6-day workweek is not cost effective or productive.

Question: How many years can the production shortfall be postponed by these and other actions?

Answer: The production of 15 billion coins as requested in our FY 1981 budget will precipitate a coin shortage. Our Mint and Federal Reserve Systems combined inventory is decreasing this fiscal year due to the heavy demand for one cent coins. The production shortfall cannot be postponed beyond the beginning of FY 1981.

Question: As a practical matter, what would happen if we would have a production shortfall?

Answer: The only alternative for the Mint and the Federal Reserve Banks is to allocate available coin supplies. This action will only magnify the shortfall as the coin shortage will feed on itself.

Overall Strategy for U.S. Currency

Question: Late last year, the results of a Treasury/Federal Reserve Board Task Force were released that recommended an overall strategy of forcing the use of the Susan B. Anthony Dollar coin as well as the use of the $2 bill by eliminating over time the $1 bill. What is the current Treasury or administration position on this matter?

Answer: The study was sent to Congress and made public as part of the review process before decisions are made. The report is intended as a planning document and not as a statement of Departmental policy. The Department of the Treasury has not made any policy decisions concerning changes in $1 coin and note circulation, and will not do so without full consultation with the Congress.

Question: Is Treasury considering any more changes to the U.S. currency system?

Answer: The Mint is currently considering the possibility of utilizing alternative alloys to manufacture the cent. The most promising change would be zinc electroplated with copper which would achieve an annual savings of over $50 million. No decision however, has been reached at this time. The Department will consult with Congress on any recommendations for an alloy change in the cent.

In accordance with suggestions made by the public and Congressional sources, the Mint has initiated further tests to determine the feasibility of modifying the color and changing the reverse design of the dollar coin to heighten its distinction from the quarter.

We do understand there is pending legislation concerning the method of printing the reverse of the $1 note. However, this falls under the purview of the Bureau of Engraving and Printing.

Support Services

Question: An increase of $1.5 million and $800,000 of increases are requested for increased support services for the Manufacture of Coins activity and the Gold Medallion Program, respectively. Specifically, what is the justification for these two requested increases?

Answer: The increases in Support Services for Manufacture of Coins ($1.5 million) and the Gold Medallion Program ($800 thousand) are distributed to the following object classes:

--- Rent, communications and utilities

Manufacture of Coins	$ 638,000
Gold Medallions	$ 40,000

(This increase is attributed to the impact of inflationary energy costs).

--- Printing and Reproduction

Manufacture of Coins	$ 5,000
Gold Medallions	$ 37,000

(This increase is attributed to the impact of inflation).

--- Other Services

Manufacture of Coins	$ 479,000
Gold Medallions	$ 709,000

(These funds are used to pay increased costs for contractor services; also $400,000 is planned expenditures in complying with OSHA standards and $600,000 for blank fabrication for the Gold Medallion Program).

--- Supplies and Materials

Manufacture of Coins	$ 426,000
Gold Medallions	$ 52,000

(These funds will be used to purchase additional die steel for manufacture of blanking and stamping dies, to procure twill for manufacturing coin bags and to purchase contractor made coin bags.)

Senator Chiles. We thank you. The Bureau of Engraving and Printing is not requesting an appropriation for fiscal year 1981 since the Department operates on a revolving fund and is reimbursed by customer agencies and while we will not take testimony from the Bureau this afternoon, the committee continues to be concerned about the reports of management and techniques and cost accounting techniques and lagging productivity.

Because of these problems, the committee does have a number of questions that we will submit for the record and we will also submit the full statement of Harry Clements, Director of the Bureau of Engraving and Printing, in the record at this point.

[The information follows:]

STATEMENT OF HARRY R. CLEMENTS

INTRODUCTION

Mr. Chairman and distinguished members of the Subcommittee, I am Harry R. Clements, Director of the Bureau of Engraving and Printing. I am pleased to appear before you today to report on our progress during the past year. With me are the Bureau's Assistant Directors and our Chief of Financial Management. I would like to introduce Robert J. Leuver, Assistant Director for Administration, Milton J. Seidel, Assistant Director for Research and Engineering, Larry E. Rolufs, Assistant Director for Operations, and Maurice M. Schneider, Chief, Office of Financial Management. Mr. Seidel, and Mr. Rolufs are appearing before the Subcommittee for the first time; their biographies are attached for submission into the record.

In my last appearance before this Committee, Mr. Chairman, you mentioned certain findings which had been included in the Department's management review of the Bureau of Engraving and Printing. As you are aware, these findings were also discussed before the Senate Permanent Subcommittee on Investigations. In its report, your committee requested that it be kept informed of our progress to modernize the Bureau's management processes and to improve productivity. In response to that request, we have prepared a report of our efforts in these areas, which will be forwarded to the Committee by Under Secretary, Bette B. Anderson.

I have also prepared a detailed account of the status of the Bureau which I would like to submit for the record. It details the improvements to management procedures and operations, and describes strides made in personnel and affirmative action, financing, manpower, and meeting present and future capitalization requirements of the Bureau. It also highlights special issues and proposed legislation that will be of interest to you.

I will limit my introductory remarks to the topics of Bureau financing, proposed legislation, capitalization, the special issue of the potential production of gas rationing coupons, and equipment acquisitions.

FINANCING

As you know, the operations of the Bureau are financed by means of a revolving fund established by Public Law 656, in August 1950. Consequently, the Bureau is not requesting an appropriation for fiscal year 1981. However, the program costs reflect the administration's March 31, 1980 adjustments to the budget.

LEGISLATIVE REQUESTS

A legislative proposal which would authorize the Bureau of Engraving and Printing to use recording clocks to record the time and attendance of employees has been introduced in the Senate as S.2063. Another legislative proposal which would authorize the use of offset printing for printing currency backs for $1 Federal Reserve Notes would result in a considerable reduction of Bureau expenses, as compared to the intaglio method the Bureau is currently required to use.

CAPITALIZATION

Our Major Capital Equipment Acquisition Program for fiscal years 1980-1981 has been approved by the Office of Management and Budget in the amount of $32.2 million. This program will assure the Bureau the capacity to produce the volume of currency, postage stamps, and other products forecasted for the period 1981-1985. It will also provide much needed press time for testing ink, paper, new processes of examining, and craft training.

STANDBY GASOLINE RATION COUPON PRODUCTION PLAN

Bureau management, along with other Federal agencies, has been working closely with the Department of Energy staff in the development of a standby gasoline rationing plan. As now planned, coupons will be produced by the offset lithographic printing method with a complex multicolor design. There is not enough intaglio printing capacity in the private and public sectors to provide the production of a one-time use intaglio design without interrupting the supply of U. S. currency and food stamps.

Included in our capital investment plan for fiscal year 1980 is $6.5 million for the acquisition of two high-speed, web offset printing presses and related equipment to provide the capacity to produce 60 percent of the volume of gas rationing coupons needed. The balance would be produced through commercial contract.

In case rationing coupons are needed before we can appropriately expand our offset capacity, a consortium of top quality Washington, D. C. area Government printing facilities has been established such as Defense Mapping Agency, U. S. Geological Survey, Department of Commerce's National Ocean Survey, and Office of Aeronautical Charting and Cartography. These agencies can provide the volume of coupons needed on an interim basis.

EQUIPMENT ACQUISITIONS

The Bureau has included in its major capital equipment program the purchase of two currency presses with an option for two additional presses. These presses are needed first, as our current presses are becoming obsolete and second, since the Federal Reserve System requirements for fiscal years 1981-1985 exceed the capabilities of our present press equipment. Also, in response to increasing requirements for currency production, we are purchasing two additional currency overprinting and processing units for delivery in fiscal year 1981.

Significant breakthroughs in web intaglio press technology have resulted in a reassessment of the traditional sheet-fed intaglio printing of currency by the Bureau. These recent developments have enhanced the possibility of printing of web intaglio on both sides in one pass through the press as opposed to current sheet-fed press technology which involves two passes through the press. It is anticipated that the web-fed currency press to be developed will increase production capability by 33%.

In an effort to replace obsolete equipment and reduce unit cost through improved technology, the Bureau contracted for replacement postage stamp coil manufacturing equipment during 1978. The equipment will be delivered in FY 1981.

A complete analysis was made of future Postal Service requirements for multicolor intaglio postage stamps. This analysis indicated the need for two multicolor web intaglio presses.

Therefore, the Bureau procured for delivery in 1981 one multicolor web intaglio press and negotiated an option for delivery of an additional press at a future date. The acquisition of this equipment will greatly enhance the quality of the product available to the Postal Service as well as significantly reduce the unit cost of multicolor intaglio postage stamps.

SUMMARY

In summary, the Bureau had a very productive year in FY 1979. We expect to be equally productive in FY 1980 as we establish a basis for new and improved operations in FY 1981.

That concludes my opening remarks, Mr. Chairman, and I will be happy to respond to questions you or other members of the Committee may wish to ask.

ADDITIONAL COMMITTEE QUESTIONS

PLANS TO DEVELOP AN AUTOMATED FINANCIAL MANAGEMENT INFORMATION SYSTEM

Question: Has the Task Force begun work on the new system? Will outside help be used to assist in development of the system? If so, has a contract been awarded for such assistance?

Answer : Yes, the Task Force has developed a comprehensive statement of work which is the major part of a solicitation for the purpose of engaging the services of a contractor to perform a requirements analysis and to develop a conceptual design for an automated Financial Management Information System for the Bureau. The solicitation was released to the public on April 7, 1980, and will remain open until June 9, 1980. We anticipate that a contract will be awarded by late July, 1980.

Question: Has work to date established any estimates of approximate time and cost to implement the system?

Answer : The following time and cost estimates have been developed for the FMIS project:

	Purpose	Target Date for Award	Target Date for Completion	Estimated Cost
Contract #1	Requirements Analysis and Conceptual Design	July 1980	March 1981	$500,000
Contract #2	Detailed Design and Implementation	Feb., 1982	April 1983	$1,250,000
Contract #3	Equipment Acquisition Per Contract #2	Oct., 1982	Jan., 1983	$1,250,000

Question: Has the new ADP Steering Committee been meeting regularly and playing a major role in the development of the system?

Answer : The ADP Management Committee as a steering committee, has been meeting regularly, on a near-monthly basis. The FMIS Task Force has been providing the Committee with project status reports on a regular basis. The Committee is interfacing the project with the Bureau's overall short and long-range ADP program, and provides direction accordingly.

Question: What action has been taken to insure Bureau-wide participation in the project and continuity in the event of staff turnover or other disruptions?

Answer: The Task Force has been staffed with the objective of providing representation of all relevant organizational components and corresponding expertise. Task Force members are from the Offices of Financial Management, Audit and Internal Affairs and Management and Systems.

Solicitation documents, prepared by the Task Force, were reviewed by all Bureau organizational components, as well as Treasury Offices which have oversight responsibilities for BEP. GSA has rendered invaluable service in the solicitation process. Suggestions from all interested parties have been incorporated into the final solicitation package.

In addition, the ADP Management Committee, composed of a cross section of all Bureau functions, is kept informed on the status of the project on a regular basis.

A Project Manager for the Task Force has been selected through the merit promotion process to direct and coordinate the efforts of the Task Force and, subsequently, to monitor the progress of the contractor on a daily basis. A Deputy Project Manager has also been appointed to insure continuity. The other Task Force members have been assigned to the project on a full-time basis for its duration.

The Bureau's Financial Manager and the Assistant Director (Administration) are regularly apprised of the project's progress via weekly status briefings.

A meeting is held by the Task Force on the first Wednesday of every month to which the Executive Staff and other top-level management officials (both BEP and Treasury) are invited. At this meeting, the progress of the project is assessed and a brief description of work to be performed during the following month is presented.

BILLING RATES

Question: What techniques are employed to forecast funding requirements?

Answer : Estimates of future funding requirements are based upon a combination of several factors, as indicated below:

1. Customer agencies formulate six year projections of future demand for BEP's products. These estimates are submitted to the Bureau annually, indicating expected product volume and mix.
2. Estimated product costs - The Bureau develops estimated unit costs for the products indicated in customer agency requirement projections. These costs are predicated upon recorded historical costs modified by such known factors as changes in labor rates, material costs, productivity and overhead rates.
3. Other factors - Total funding requirements include anticipated changes in working capital and estimated cost of planned capital equipment acquisitions.

Question: Are these projections accurate? If not, Why?

Answer : Yes, projections of the total Bureau program and composite billing rates (i.e. U.S.P.S. book, coils and sheets) are generally accurate over the yearly accounting cycle. However, over shorter periods than the yearly accounting cycle, projections for individual products can vary from actual due to product mix, volume levels and seasonal productivity variations.

1979 SURCHARGE COLLECTIONS

Question: In Fiscal Year 1979 the Bureau originally estimated surcharge collections of $8 million and you collected about $15 million. Why is there such a difference between projected and actual collections?

Answer : When the original 1979 surcharge was developed during Fiscal Year 1978, it was anticipated a surcharge in the amount of $8 million would be required. The original plan was reviewed during 1979 and was adjusted to $15 million. This adjustment resulted from additional equipment being approved and the escalation of costs of items already included in the Bureau fixed asset investment program. The equipment requirements were determined by a comprehensive reassessment and plan devised to: a) meet long range requirements projected by major customers and programs; b) do so with only normal overtime (reduced from existing Bureau practice) c) allow machine downtime for cost effective preventative maintenance and relieve dependence on antiquated, difficult to maintain equipment; d) take advantage of established and developing technology that will provide reduced overall cost (better productivity), higher quality, or both. The plan and its derivation were reviewed and approved by Treasury Officals, OMB and management of the FRS and USPS.

Question: How long do you expect these increases to continue?

Answer : Increases will continue over at least the next 5 years as a result of environmental impact requirements, the increased volume and complexity of products needed by Bureau customers and increased efforts to substantially increase productivity through new and vastly different equipment.
The majority of the production equipment at the Bureau is fully depreciated and has been operating 3 shifts a day for 15 or more years. This equipment has become increasingly uneconomical to operate due to costly downtime and technological obsolesence.

Question: Why didn't the Bureau reduce its billing rates in fiscal year 1979 when it was realized that more funds were being collected than was originally planned in the capital budget?

Answer : The Bureau did reduce its billing rates during the year for postage stamps but did not reduce its rates for currency due to the need to fund its currency equipment program which was approved during the year. The Bureau operated at a loss of $511,000, for FY 1979, after incorporating charges for the revised capital requirement.

Question: Are operating profits (excess of product billings to production costs) used to fund fixed asset acquisitions?

Answer : Yes, Legal Counsel has advised the Bureau that Public Law 95-81 supersedes the 1950 Act to the extent that the Bureau may retain payments received, including "excess" operating income (i.e., income beyond that retainable under the 1950 Act) in amounts sufficient to permit acquisition of capital equipment and provide for future working capital. GAO has issued an opinion which additionally supports the Department's position on retained earnings.

Question: In Fiscal Year 1979 didn't you accelerate the funding of your capital budget to prevent returning funds to the Treasury?

Answer : Capital funding was increased to accommodate the revised major equipment program previously described. According to the GAO and Treasury Counsel operating profits can be used for either required equipment or needed increases to working capital. According to these opinions the Bureau properly retained the surplus collected in FY 1979 since the funds were required for established future equipment requirements. Because there was no requirement to transfer customer funds to the Treasury, the Bureau had no need to artificially accelerate its capital budget.

Question: How often are surcharge rates changed? And why?

Answer : Surcharge rates are changed periodically as needed. We attempt to forecast the Fixed Assets Budget one year in advance. Surcharge requirements are determined when capital acquistions are confirmed. Changes in those rates are made during the year based upon varying product volume, related equipment needs and the effects of inflation on equipment costs, after intensive review by management regarding the criticality of these needs ranked by priority.

SURCHARGE USAGE

Question: What types of products or services are purchased with surcharge collections?

Answer : Major capital equipment costing in excess of $200,000 will also be purchased from surcharge receipts. Capital equipment includes applicable site preparation, installation, and environmental assessments. Additionally, certain services which will be capitalized and amortized will be purchased with funds received from surcharge receipts. Finally, inflation may require an increase in working capital in order for the Bureau to be able to manage its payables of all types. This requirement can also be raised through surcharge.

Question: How are capital equipment requirements related to surcharge?

Answer : Selected services and capital equipment requirements costing in excess of $200,000 will be purchased from surcharge receipts.

BORROWING AUTHORITY

Question: What is the status of the Bureau's request for borrowing authority?

Answer : Draft Legislation has been prepared and is under Departmental review.

Question: If borrowing authority is approved will BOEP continue to assess surcharge? Why?

Answer : If borrowing authority is approved the Bureau will continue to assess surcharges for required increases in working capital and for comparatively routine equipment requirements.

Question: How will borrowing authority monies relate to surcharge collection (i.e. what will borrowing monies be used for vs. surcharge collection monies)?

Answer : Borrowing authority monies will be used for abnormal and large dollar value acquisitions for which it is not practical to obtain surcharge funds because of time limitations. Examples would be high cost environmental or safety equipment requiring immediate installation, major renovation, or investment in substantial technology innovation in equipment that offers rapid payback.

Question: How much money will have to be borrowed in the next year? Two years? Five Years?

Answer : We project the following need to borrow funds from the Treasury:

Fiscal Year	Amount (000 omitted)
1982	$21,000
1983	$36,000
1984	$30,000
1985	$20,000
1986	$20,000

Question: How was this funding requirement determined?

Answer : The funding requirement was determined by analyzing trends in environmental control and technology, and reviewing areas of BEP that have not in recent years received commensurate considerations in allocation of funds for modernization and improvements. Some were found to offer significant improvement in productivity if the capital were available to invest, or where funding priorities, were such as to allow us to initiate them (examples space reallocations within existing buildings, and modernization of ink production facilities). The following is the total list of planned and desired capital projects, by year: (See Attachment A)

OVERHEAD

Question: What has been done to reduce the Bureau's overhead structure? (Provide examples where major reductions have occurred.)

Answer : During the summer and Fall of 1978 the Bureau imposed a freeze on administrative overhead positions. As a result, the number of such positions was reduced by about 13%, from 750 to 650.
In addition, during FY 1979 and 1980 accelerated efforts have been, and are being made to automate overhead functions.
Some of these are as follows:

a. Conversion of manually operated elevators to self operation. It is anticipated that this will reduce personnel requirements by 7 positions by the end of FY 1981.
b. Installation of card operated turnstiles and other automated security access devices within the Bureau. It is anticipated that this will reduce security personnel requirements by 10 positions.
c. Automation of time/attendance and labor distribution devices. It is anticipated that this will save about 150,000 clerical hours annually, which will eliminate the need for 75 administrative positions.
d. Conversion to data entry terminals from keypunch required operations in the Bureau payroll system should eliminate the need for at least 6 administrative positions.
e. Installation of a sophisticated word processor in the Bureau's Office of Materials Management. It is anticipated that this will eliminate the need for about 10 positions whose function is to manually post stock control information to cards.
f. An internal industrial engineering study of the material transfer function could possibly reduce assigned personnel requirements by 20 positions.

WORK MEASUREMENT

Question: Have you implemented work measurement standards?

Answer : Yes, the Bureau has implemented work measurement in the production areas, for example in note examining and currency overprinting.

Question: Do you plan to initiate such standards?

Answer : Yes, the development of Production Standards relevant to operations that have not yet been reviewed is a full-time function of approximately four members of the Operations Analysis Staff.

Efforts are also underway to establish Productivity Standards for administrative functions. Bureau senior management is discussing means to initiate a program relating to administrative productivity.

Question: What progress have you made?

Answer : Approximately 40% of the craft and non-craft positions in the Bureau are either subject to Production Standards or are currently under review to determine applicability of Production Standards.

Question: What has been the reaction of the large number of Unions at the Bureau?

Answer : Most of the Bureau's Unions and their members have cooperated with management's efforts to improve methods and establish Production Standards. In several cases this cooperation has resulted in substantial improvements in productivity and cost reduction.

However, despite Bureau efforts to solicit Union input and cooperation one craft Union has delayed efforts to establish Production Standards.

Question: Have you solicited Union participation in setting standards?

Answer : Yes (see preceding statement).

FINANCIAL CONDITION OF THE BUREAU

Question: The Balance Sheet for the Bureau shows a $15,000,000 reduction in fund balances and an $18,000,000 increase in fixed assets. Please explain these changes.

Answer : The $15 million represents working capital which was previously collected to purchase the $18 million worth of equipment. The difference of $3 million is represented in accounts payable.

Question: Does the $18,000,000 increase in fixed assets anticipate the capital expansion program for which the Bureau intends to request legislative authority?

Answer : No, the Bureau intends to collect the funds for the capital expansion program through surcharges to customers.

ATTACHMENT A

PROJECTED LONG RANGE CAPITAL EQUIPMENT REQUIREMENTS
FISCAL YEARS 1982 - 1986
(IN THOUSANDS)

ITEM	FY 1982	FY 1983	FY 1984	FY 1985	FY 1986
Automatic Ink Maufacturing		$ 1450.	$ 1000.		
Intaglio-8 Currency Presses					
Web Postage Presses ("B")			3000.		
Web Currency Presses		400.		$ 8622.	$ 11235.
Perforating Equipment	$ 900.				
"A" Press Rework					
Coating Project		7117.	3247.		
Accountability Equipment					
Retrofit Existing Equipment for Accountability	250.	250.	250.	250.	
Currency Overprinting	4000.				
Automatic Currency Inspection Equipment (10)	5000.	10000.	5000.		
Space Relocation	1000.	1500.	1500.	1500.	
Web On-Line Gross Error Detection		1050.	1050.	1050.	
COPE Packaging	1000.				
Air Conditioning Capacity	525.				
Environmental Control	2930.	5000.	2000.	1000.	
Postage Stamp Paper Processing			3000.		
Automated Financial Information	1750.	300.	500.		
Uncorrected Totals	$17355.	$27067.	$20547.	$12422.	$11235.
Inflation Correcting Factor	1.21	1.33	1.46	1.61	1.78
Total Estimated Requirements	$ 21000.	$ 36000.	$ 30000.	$ 20000.	$ 20000.

SUBCOMMITTEE RECESS

Senator CHILES. We will stand in recess until 10 a.m. tomorrow.

[Whereupon, at 4:30 p.m., Tuesday, April 22, the subcommittee was recessed, to reconvene at 10 a.m., Wednesday, April 23.]

LIST OF WITNESSES, COMMUNICATIONS, AND PREPARED STATEMENTS

Page

Anderson, Wayne F., statement 279
Archey, William T 144, 161
Asack, Bob 155

Benson, C. Neil 717
Bolger, William, statement 718, 728, 746
Brandstatter, Arthur F., statement 439
Burke, Robert R 455

Carswell, Robert, statement 792, 800
Chasen, Robert E., statement 122, 160
Choen, N. Jerold 643
Clements, Harry R., statement 845

Davis, Richard J., statement 119, 160, 319, 339, 368, 381, 436, 456
Dickerson, G. R., statement 320, 362, 377
Dooher, John C 435
Dunn, James S 319, 359

Feffer, Jerry 571, 639
Ferguson, M. Carr, statement 571, 572
Finch, Jim 717, 728

Giuffre, John F 455, 461
Gregg, William M 257
Greiner, William A 257
Gunner, John 509, 555, 568

Hackel, Stella B., statement 822, 838
Harris, Dan 509, 555, 569
Heymann, Philip 571, 585, 636
Higgins, Stephen E 319, 369
Hintgen, H. J., statement 258
Holsopple, Eleanor J 257

Jones, Arnold, statement 510, 568
Jordan, Walter L 217

Kallen, Arthur D., statement 77, 217, 319, 435, 455, 643
Keathley, Miles 319
Kleine, Robert 217, 297
Knight, Stuart H., statement 459, 481
Kump, Joseph 643
Kurtz, Jerome, statement 656, 674

McDonald, W. J., statement 65
McKinley, David W 435
Miller, William G., statement 4
Morton, Azie T., statement 266
Murphy, Gerald, statement 220, 235

Neverman, David P 257
Nuzum, Charles 311, 315, 317

Page

Palmer, Frank 455
Powis, Robert E 455

Rath, Kenneth 257
Reeder, Richard 217
Rivlin, Alice 705

Serlin, Michael D 217, 241
Shannon, John F 277, 282
Simpson, John R 455, 460

Taylor, Paul 217, 257

Ulsaker, Carl 717

Voss, Allen, statement 48

Weinstein, Myron I 455
White, Frederick N., Jr 455, 460, 481
Wigrizer, Leon, statement 60
Williams, Bill 643
Wilson, Kenneth L 162

SUBJECT INDEX

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

Page
Accuracy of first study ... 297
Anderson, Wayne F., statment of ... 279, 283
Chiles, Senator, questions submitted ... 306
Cigarette bootlegging ... 277
Error rate ... 298
Explanation of estimates ... 296
Nondepartmental witnessess:
  Federal response ... 312
  Severity of problem ... 311
  Success of investigative activities ... 312
Relationship between tax and consumption ... 298
Special characteristics of Florida ... 301
Statistical methodology ... 297

DEPARTMENT OF THE TREASURY

Accuracy of forecasts ... 36
Administrative travel ... 76
Basic justification for withholding proposal ... 28
Budget assumptions ... 35
Budget proposals for the Office of the Secretary ... 71
CBO figures:
  Impact of energy price on inflation ... 38
Chiles, Senator, questions submitted by ... 80
Customs drug traffic ... 43
Economic factors for 1980's ... 31
Economic impact of withholding program ... 24
Energy price impact on inflation rate ... 36
Exemptions from interest withholding ... 23
GAO report conclusions ... 47
GAO report summarized ... 45
High interest rates ... 29
Housing and interest rates ... 30
Income levels of people receiving dividends ... 26
Inflation and Government regulations ... 29
IRS exemption ... 46
IRS stops pursuit of drug traffickers ... 43
Insurance analysis program ... 75
Interest and dividends withholding ... 22
Internal Revenue Service audits ... 41
Kallen, Arthur D., statement of ... 77
Lending ... 32
McDonald, W. J., statement of ... 65, 72
Miller, William G., statement of ... 4
Oil ... 32
Paperwork burden from withholding system ... 24
Role of Treasury IG ... 69
Schmitt, Senator, questions submitted by ... 104
Secretary, remarks of ... 21

Page
Tax simplication 43
Unfounded optimism 33
Unreported income 28
U.S. energy priorities 39
U.S. savings bonds 41
Voss, Allen R., statement of 48
Wigrizer, Leon G., statement of 60

BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

Alcohol application procedures, new 367
Arson 367
Bayh, Senator, questions submitted by 406
Budget request 319
Chiles, Senator, questions submitted by 383
Cigarette smuggling program 344
Criminal enforcement 364
Davis, Richard J., statement of 339, 343, 362
Dickerson, G. R., statement of 320, 343
Equal Employment Opportunity 367
Explosives, tagging research on 366, 397
Laxalt, Senator, questions submitted by 410
MAC-10 problem 365, 373

BUREAU OF ENGRAVING AND PRINTING

Additional committee questions 849
Capitalization 846
Clements, Harry P., Director, prepared statement 844
Equipment acquisition 847
Financing 846
Legislative request 846
Standby gasoline ration coupon production plan 846

BUREAU OF GOVERNMENT FINANCIAL OPERATIONS

Bank offsets 241
Budget request 217
Chiles, Senator, questions submitted by 243
Claims operations 235
Claims system 237
Hintgen, H. J., statement of 258
Lack of resources or knowledge 236
Morton, Azie T., statement of 266
Murphy, Gerald, statement of 221

BUREAU OF THE MINT

Additional committee questions 842
Automatic data processing 828, 837
Coin:
    Inventories 838
    Production 822
    Requirements 823, 835
Continuing audits of gold 832, 837
Deposit activity 824, 836
Equal Employment Opportunity 833, 837
Equipment acquisition 826, 837
Gold medallions 827, 837
Hackel, Stella B., Director, Bureau of the Mint, prepared statement of 821
Internal audit 831
Numismatic and other reimbursable operations 828
Personnel 834
Production costs 839

Page
Protection activity 825, 836
Refining activity 826, 836
Safety and health 830, 837
Status of gold medallion program 839
Summary of statement 835
Susan B. Anthony coin 840

BUREAU OF THE PUBLIC DEBT

Additional committee questions 274
Budget request 257
Federal Reserve Bank reimbursements 270
Fiscal year 1980 supplemental request 269
Fiscal year 1981 appropriation request 270
Morton, Azie, Treasurer of the United States, prepared statement 257
Summary statement of Mrs. Morton 271

FEDERAL LAW ENFORCEMENT TRAINING CENTER

Brandstatter, Arthur F., statement of 439
Committee questions additional 451
Davis, Richard J., statement of 436
Inspector General, organizations training for 446

INTERNAL REVENUE SERVICE

Annual appropriation review 647
Chiles, Senator, questions submitted by 679
Commissioner welcomed 643
Ferguson, M. Carr, Department of Justice, prepared statement 571
Grand jury investigations 559
IRS administrative reforms recommended by GAO 555
IRS/Customs coordination 568
Jones, Arnold, General Accounting Office, statement of 510
Kurtz, Jerome, statement of 655
Narcotic traffickers 507
Questionnaire to U.S. attorneys on tax act 587
Sealed bid sale notice 672
Selected tax act exemptions for IRS 586
Schmitt, Senator, questions submitted by 700
Special agent, overtime 654
Special agents, subject to penalties of law 637
Summary of budget request 674
Training for U.S. attorneys 582

INTERNATIONAL AFFAIRS

Budget request 793
Carswell, Robert, Deputy Secretary of the Treasury, prepared statement of 791
Chiles, Senator, questions submitted by 802
Overlap of activities with State and Commerce 798
Trade with the Soviet Union 800

U.S. CUSTOMS SERVICE

Additional committee questions 166
Additional inspector positions 162
Air interdiction module test 144
Aircraft utilization 150
AWACS capability 155
Centralized control of the air interdiction program 146, 147
Centralized policy and operation guidance 149
Chasen, Robert E., Commissioner of Customs, prepared statement 122

Page

Davis, Richard J., Assistant Secretary, Enforcement and Operations, prepared statement 119
Deficiency in regional command structure 148
Economic effect of illegal funds 145
General oversight hearing 157
Organizational structure of air program 146
Overtime pay cap 161
Reduction of the number of regions 159
Summary of increases requested for fiscal year 1981 140
Transferring headquarters positions 160

U.S. SECRET SERVICE

Additional committee questions 484
Davis, Richard J., statement of 456
Investigative statistics 484
Military aircraft use of 483
Noncampaign travel costs 482
Reimbursements to State and local governments 484
Supplemental request, 1980 481
Travel limitation 481

U.S. POSTAL SERVICE

Additional committee questions 750
Bolger, William F., Postmaster General, statement of 718
Budget request 717
Chiles, Senator, opening statement 705
Deficits in fiscal years 1980 and 1981 729
Electronic message services 734
Elimination of Saturday mail delivery 712
Fiscal year 1981 employment decrease 730
Revenue forgone shortfall 728
Second and third-class mail 727
Susan B. Anthony coin promotion 749
Zip code expansion 724

O